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Foreword

Shijing Liu

China Economics—1997 is the fourth volume in the series of annual publications. The selection work during the process of compiling the volume was in accordance with the agreed upon programme where 25 essays, amount many others recommended by the Compilatory Committee consisting of 8 out of 14 predetermined members for various reasons, were chosen as candidates by the Executive Chief Editor (a rotating position amongst the members of the Committee). Within the 25 candidates, 13 were finalized with the rest out for failing to gain the pre-decided one half of the votes cast by all eight members of the Committee. In the light of the views forwarded by most members, the Editor thereafter chose another two essays via mail voting from the newly recommended to make it 15 in the volume presented now.

As the Executive Chief Editor, I would like to talk

more about some important issues deliberated by the Committee during the process of the selection. First of all is the issue concerning the selection criteria. The original aim of compiling the volume is to promote the modernization of economics in China. To put it in details, the idea is to conduct economic research by utilizing modern economic concepts and methods, or if you like, "economic norm". Surely, the emphasis of the research ought to be placed on the domestic economic issues. Having such an aim as a criterion, though, is very much preferable, it would not be easy for such a criterion to be clearly defined.

Once talking about the "norm" of modern economics, the first thing in mind would probably be those in respect of the neoclassical school of thoughts, such as basic concepts, assumptions, hypotheses, inference, conclusion and so forth. It is true that such a norm represents the mainstream of economics in the West, but it would not be monolithic without variation. The research style of R. H. Coase of Institutional School, for example, is quite different from that of P. A. Samuelson of Neoclassical School. Even so, it does not make any difference at all as for them to obtain the Nobel Prize in Economics.

In view of the Chinese research papers, there are quite numbers of them that do not strictly follow the norm in the mainstream of economics, some of which are even presented in the form of report. Not all, of course. They, nevertheless, put forward some of important issues, concerning not

only China's economic development, but also the development of economics. Some of the essays chosen in this volume, for example, contain the themes of strategic restructuring of current command economy, and transformation of China's industrial structure and enterprise's organization. Amongst these papers, there is also no shortage of insights into various theoretical issues. If, however, they were treated solely on the basis of the norm, it would be quite easy for them to be dismissed. But the trouble is that the situation is not that simple.

For one thing, these papers, though not strictly in conformity with the norm, are still on the track of the modern economics in terms of the way of thinking revealed. Moreover, they do demonstrate their own styles of research instead of the standardized fashion in the mainstream of economics. And this would give rise to the scepticism of following headlong the norm of mainstream. Coase's path-breaking work on the issues of firms, for example, was written in the form of narration. So were many of his writings thereafter. It is indeed difficult to conclude that these later works of him are purely descriptive or anti-theoretical, as such an criticism is less likely to bear up to close scrutiny.

For the other, these papers in their own unique styles pinpoint those important issues and also provide prognoses for them, especially when in contrast with others. Here, it is worth noting that one of the main reasons why economics is so attractive is that it always probes into the pragmatic is-

sues in the past, the present and the future, and that it not only attempts to explain them, but also offers predictions and forecasts.

In fact, it is just this kind of papers and the like that have had the strongest impact upon society and thus contributed the most over the reform period of the past 20 years, as they delved into those important issues in that particular period. Hence, it is not an easy task to give a judgment on which is good or bad solely on the basis of conformation to the norm.

Yet, such circumstances have, to a certain extent, presented to us the situation of "catch 22", very awkward indeed. Insofar as the selecting work of this volume is concerned, the best choice would be that the paper is, in one way or another, in line with a certain form or norm of the modern economics while tackling important issues. Unfortunately, the reality is not as satisfactory. As for us, it is not a hard decision to write off those without real substance, regardless of the form they take, but it does create a kind of dilemma when the situation is actually the other way around as demonstrated above. The fact that some of them have been chosen does not necessarily mean our slackening the effort for modernization of economics in China. Nor does it reflect the situation that they have lived up to the standards required. What it really represents is the understanding given rather objectively to the current state of the development of the economy and economics in China.

Moreover, having done this way also gives full expression to our own belief that there is no reason for keeping one kind of norm for good while rejecting others that, of course, include the norm taken by Chinese economists when dealing with their own specific issues. In other words, it is not impossible to develop "China's economics". Alas, whether involving such a belief in the selection criteria is appropriate or not is far from clear. What we could do is to leave the plight to our dear readers, hoping they would come up with a satisfactory solution.

The other issue that I would like to emphasize is about the "includability" of selection, that is, an arrange of areas that the selection covers. As a matter of fact, a compiling work is always constrained by compilers' knowledge, experience and vision. The more the laxity in such a constraint, the better, especially when the aim of the compilation is to promote the all round development of economics in China. A particular attention has thus been paid to the balance of the areas covered right from the preliminary selection. As a result, the themes of the essays included in the volume spread across various aspects of economic life, such as economic growth, business cycle, macro-policies, foreign trade and exchange, labour flow, the SOEs' reform, agricultural policies, institutional transition and so forth.

As well as keeping the balance amongst various fields of the research, the issue of the "includability" also reflects the situation where the selection pays tribute to the econom-

ic research fields, especially those with that the compilers are not familiar and where progresses have been made. Moreover, it represents an incentive mechanism that would be very much conducive to the development of specialization in economic research. That this is so reflects the fact that China's economy has already entered into the period where a sustainable growth relies heavily upon specialization. As the study of economies, the development of economics in China would also bear the trend. Specialization in the research will inevitably lead to continuous separation of the research fields. Hence, the includability of selection would serve as a kind of recognition of and encouragement to such a trend.

From here onward, I would like to give a sketch of the essays included in the volume in order for readers to have a general view of them. Within the volume, there are four papers tackling the macro-issues. The paper written by Xuebin Chen on *Release of Policy Information under the Condition of Information Asymmetry and the Impact upon the Effectiveness of Domestic Monetary Policy* provides a preliminary analytical framework by establishing a game theory model in the domestic financial market under the circumstances of Information Asymmetry. The model attests to the hypothesis that a discretionary monetary policy with a release of policy information in advance would be more effective than the policy without, when under the condition of Information Asymmetry, but less effective than a fixed rule

policy regardless of the information release manner.

Nevertheless, when policy makers are more concerned about long term interests, plus the existence of stable monetary targets with more accurate prediction of money demand and better control of money supply, the discretionary policy is at least as effective as the policy by rule in terms of reducing the level of average inflation, the amplitude of its fluctuation, and uncertainty. And this has a strong implication for the domestic economy where the demand for and supply of the currency in the transitional period are subject to a larger fluctuation. Hence, the paper concludes that there would be no urgent need to adopt a fixed policy rule, given the priority of the monetary policy is to generate growth while maintaining the domestic price stabilization.

By probing into statistical data, Duo Qin casts double upon the popular notions, "the stability of demand for money in China has been broken down by the reform", and "money supply is always playing a conspicuous role of vanguard in the growth of output and inflation". In her paper on *The Relationship between Demand for and Supply of Money in China since the Reform*, Qin, assisted with the results of an econometric model, attributes the inappropriateness of the notions to the incompatibility of "Quantitative Theory of Money" with the transitional economy of China. The main finding of her paper is that once taking into consideration the specific institutional factors in China, the demand for money exhibits stronger stability. This means that

the quantity of money is in the long run determined by the demand. Even if in the short run, the discretionary scope for expansionary monetary policy is quite limited.

The well-known Phillips curve represents the complex relationship amongst the rate of growth, inflation and unemployment. In the essay titled *On China's Phillips Curve*, Shucheng Liu starts with discussion on three kinds of the expressions of the curve, and the two modifications. Assisted with the third expression reflecting the relationship between the rate of growth and inflation, Liu illustrates five typical shapes of the curve ever occurred in China, and puts forward the causes for them. As well, he explains why there was no existence of the basic Phillips curve before the reform, and the curves existed after the reform have their shapes steepened. The various factors influencing the increase in the domestic prices since the reform are also analyzed by utilizing an econometric model. In the final part of the essay, Liu canvasses the specific features exhibited in China of the second expression of Phillips curve representing the relationship between the rate of inflation and unemployment, and suggests that the steepness of the curve result from the impact of factors, such as demand for and supply of labour, the SOEs' reform, and restructuring.

The Falling Global Inflation: A Prospect of Long Cycle is the last of the four essays tackling the macro-issues. In the light of the reduction of the global inflation and the subsequent sustained growth in various parts of the world, Lip-

ing He attempts to have a sound grip of such wrenching turnaround of the global economy via analyzing the underlying causes of the expected long cycle. As pointed out by He, the main factors that gave rise to the rampant growth of the world inflation during the period of the 70s and the 80s have become anything but effective. The two decades of the experience have also deepened the understanding of the hazard of inflation, and this has provided much needed impetus for the governments to set up anti-inflation mechanisms, such as forward looking stance, independent central banks, labour market reform, and micro-restructuring, in many countries most affected in the past. Such a mechanism has by now deeply rooted in those countries' economic practice and policy making process. In addition, the improvement of the international environment has also played a due role in the changes of global economy.

This volume also takes in an pure theoretical essay dealing with the growth issue. The paper, *Two-Way Net Growth Model*, authored by Xiaowen Tian critically reviews the Neoclassical Growth Model and the Keynesian New Growth Model, pointing out the important deficiencies in the theories themselves and the methods applied, such as ignoring the intangible assets or capital of institutional society, failure to explain the true productivity of the factors with mixed attributes simply by using the notion of residual values, impossibility to measure accurately the total capital involved, and inappropriateness of the attempts to explain

completely an economic growth. Built upon these growth theories, however, the new growth model has been forwarded, in which Tian not only replaces the total capital involved with the changes of capital invested whose data is much easier to be collected, but also takes into consideration the factors of the institutional society and market efficiency. Tested with the data collected from the period of 1978 to 1993, the validity of model has been proven with the satisfactory results.

There are two essays taken in the volume that concern about foreign trade and foreign exchange. One of them is *Positive Analysis of the Costs of China's Trade Protection*, the result of the collaboration amongst a group of writers, Shuguang Zhang, Yansheng Zhang, and Zhongxin Wan. The costs of the protection is measured by using a partial equilibrium model with the data of 25 kinds of products collected in accordance with the criteria of higher level of importation and higher degree of protection (i. e. the domestic production of the kinds accounts for 35% of the GNP contributed by both industrial and agricultural sectors, and the quantity of importation is about 30% of the annual total.). The procedure applied is as follows:

1. calculating the local price elasticity of and import price elasticity of demand, the cross price elasticity, and the price elasticity of supply;
2. measuring the degree to which the trade is protected in China;

3. measuring the changes in price and quantity of both the domestic and the imported products after the trade liberalization;
4. measuring the welfare benefits after the trade liberalization;
5. measuring the impact on employment of the trade liberalization.

The paper concludes that the degree of the trade protection is 43.3%, higher than that of U. S. (35.2%), but lower than that of Japan (178.2%), that the consumer surplus after the liberalization will be over ¥ 280 billion, and that the ratio of consumer surplus is 18.41%.

From various aspects, such as purchasing power parity (PPP), exchange parity, current account, capital account, monetary policy and so on, Gang Yi and Ming Fan discuss the trend of RMB exchange rate in their paper on *The Determinants of RMB Exchange Rate and the Trend*. Their main findings are as follows:

1. In 1995, RMB exchange rate, if measured by PPP, should be at about ¥ 4.2/US\$, much higher than its nominal rate. The main reason lies with those non-tradable commodities, such as housing, domestic services, etc.. With such a result, the estimated GDP for the year of 1995 would be \$1,375 billion, or \$1,145 per capita. If, however, taking into consideration those tradable goods only, the rate would be at ¥7.5/\$US.
2. If measured by relative PPP, especially in developing

countries, an adjustment necessary has to be made, as a rapid increase in the domestic inflation likely occurred during the takeoff period would not be proportionally reflected in the nominal rate. This may be due to the situation where the inflation during the period more likely concentrates on the non-tradable goods.

3. As for developing countries, the rate of increase in productivity of the tradable goods sectors over the period of the take off would normally be higher than that recorded in developed economies, and this could be one major factor pushing RBM higher.
4. The explainability of interest rate parity as to the trends of RBM would be getting stronger.
5. To maintain the balance of demand for and supply of foreign currency and the stability of the exchange rate, China should consider a kind of balance under the item of commodity trade while keeping some deficits under the current account and some surplus with the capital account.

On agricultural issues, there is one essay included, *Comparative Advantage and the Structure of China's Food Trade*, written by Feng Lu. On the issue, there has been one popular postulation that China's food trade, with the relatively open environment and the state of gradually losing its comparative advantage, would face the inevitable future of a massive net import of food much needed. Going on his truth finding expedition, Lu explores the data relevant with

respect to China's food trade and discover the "new continent" that from the 80s onward, the inflow of some of the agricultural produces, such as grain, sugar and so on, has undeniably been on the way up, the outflow of those higher value-added produces, such as vegetables, fruits, aquatic products, portrays, etc., has on the other hand recorded the rapid growth. Contrary to the popular thinking, the net export of the food trade in value terms has been not only showing the positive statistical result, but also expanding.

To look at the sectors from the supply side, many products in the sector have demonstrated their international competitiveness. This is due to the greater agricultural endowments for these products as well as the given structure of their competitive advantage. From the demand side, the story would point to the same direction that the export expansion of the products mentioned above is in agreement with the fact of shifting preference of food consumption as income grows and the long-term trend so induced of changes in the structure of international market for food. The paper also provides the policy implications for China's food trade sector.

Two essays in the volume are investigating the issues of labour flow. Shi Li's paper on *A Labour Flow Model under the Condition of Economic Transition in China* explores urban wage determinative mechanism of both the public and the private sector in the environment of transitional economy. Assisted with his theoretical model, Li finds that due to the

wage policy of egalitarianism in the public sector, which has resulted in underpaying the skilled while overpaying the unskilled, the net outflow of the skilled labour from the sector keeps on growing, and this will inevitably lead to the reduction of the average labour productivity in the sector. On the other hand, as an influx of rural labour (unskilled mainly) increases, the inflow of these skilled labour into the private sector would put downward pressure on the wages paid to the unskilled. The shifted impact of the wage policy in the public sector would ultimately result in widening the wage disparity of the unskilled between the private and the public sector. The paper in its final part conducts the simulative analysis for four relevant public policies, and concludes that some of the distortions in the labour market during the period of transition can be cleared only if the public sector adopts the market mechanism in its wage policy making.

The other paper on the issue of labour flow is Yaohui Zhao's article on *The Rural Labour Flow in Sichuan Province and the Role of Education*. Zhao, by using the statistics from the 1995 rural house-hold income survey in Sichuan province, analyzes the decision-making process of the rural emigrants, and estimates the income differences between rural emigrant workers and rural non-emigrant workers (different from farmers or peasants). One major finding is that the first choice of the rural workers is to stay put working in the rural non-agricultural sector, even though the income earning is much higher for the rural emi-

grant workers.

As for the income difference between the two sources, only a small portion can be explained by the cost of travel between the work place and the rural home and the urban housing cost. Another small part of it can be explained by the cost of obtaining "registration card" issued by urban authorities as their administrative charge. In fact, the major part of the difference stems from the much higher implicit costs existed in the process of the labour movement between rural and urban areas. Most importantly, such an implicit cost is closely related with those governments' policies intended to restrict the free movement of those rural migrants. This has given a full expression to the current situation where policy induced misallocation of the resources has grossly lowered the productivity of labour.

On the issues of enterprise reform are there two essays, one of which is written by Chunlin Zhang with the title of *The Reform of SOEs and the State Financing*. In the paper, Zhang suggests that the current situation of the reform in the state owned enterprises urgently requires those systematic and consistent theories with regard to the numerous issues associated with the enterprises. The main argument put forward by Zhang is that the basic problem of those state owned enterprises is effectively rooted in the mechanism of enterprise financing inherited from the former command economy, that is, so-called state financing in which the state serves as a sole financial intermediary. Hence, the