
Political Economy of the Beijing Consensus: Its Past, Present, and Future*

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< 목 차 >

I. Introduction	V. Conclusion
II. The Political Economy of the Reform in China	Reference
III. Challenges: Social Integration	Abstract
IV. Prospects on Mid-long Term Development of the Chinese Economy	

Key words(중심용어): 중국의 경제개혁(Economic Reforms in China), 베이징 컨센서스(Beijing Consensus), 사회적 갈등(Social Conflict), 소득불평등(Income Inequality), 소비주도적 성장 (Consumption-led Growth)

국 문 요 약

중국경제가 그 동안 이룩한 경제적 성과에 주목하고, 이를 뒷받침한 정치경제적 독특성을 일컬어 ‘베이징 컨센서’ 라는 새로운 개념이 제시되었다. 지금까지 이 개념은 중국체계의 독특성을 지칭하는 협의의 용법에서 나아가, 기존의 주류 세계가 강요해 온 경제정책에 대항하는 제3세계의 반응, 그리고 그에 따른 세계 패권의 구조적 변화를 분석하는 도구로 사용되고 있다. 하지만 이 개념은 아직 형상화되지 않았을 뿐만 아니라 그 실체가 충분히 분석되지도 않았다. 본 논문은 이러한 간극을 메우는데 기여하고자 한다. 특히 이 논문은 중국의 발전전략과 과정을 분석하고 중국이 현재 당면하고 있는 도전들을 사회·역사적 맥락에서 파악한다. 이를 통해 이 논문은, 1990년대 중반 이후 실시된 급진적 개혁방식이 내적·외적 불균형을 낳았고, 중국 당국은 이를 해결하기 위한 전략으로 국내소비 주도적 성장 체제로 전환하려 하고 있음을 보인다. 하지만 본 논문은 이러한 체제전환 전략은 단지 경제뿐만 아니라 사회 전반의 개혁을 요구하는 전략이라 주장한다.

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I . Introduction

After the Chinese Communist Party established a socialist regime in 1949, China had run a planned economic system. Under the planned economy, China recorded significant results with 6% annual average growth of the real GDP and 4.5% annual average growth of the GDP per capita (see Table 1). Furthermore, the infrastructures that had been relatively evenly constructed throughout China during this period became an important foundation of rapid economic growth since 1978. However, despite such a relatively prominent performance, the process of economic growth was not as satisfactory as initially anticipated. First, although it anticipated that the economy would be stabilized by a plan, it has experienced a greater economic fluctuation than capitalist world at the time. Especially, most of the economic fluctuation during the socialist period was caused by political decisions enough to be called political business cycles, and each business cycle often ended up with tragic results (For example, the failure of the Great Leap Forward and the consequent famine incident). Second, despite the relatively significant economic growth, the welfare of individuals under the planned economy had not been improved noticeably during this period.

Table 1. The Annual Growth rates of GDP and population in China (%)

Period	GDP	Population	GDP per capita
1953-1978	6.7	2.2	4.5
1979-2008	9.8	1.2	8.6

- Source: *China Statistical Yearbook 2009*

However, since the reform and open door policy was officially adopted in 1978, things started changing, with the Chinese economy growing more rapidly. The reasons that the rapid growth of the Chinese economy can be especially taken notice lie in the following characteristics. First, despite the burden of the enormous population, Chinese economy has grown on average at of 9.8% annually during this period, and the income per capita has grown at an annual average of 8.6%. Such an outstanding performance can be recorded as the most noticeable in the world economic history including both the East and West.

The second achievement of the Chinese economy during the reform period is its stability and sustainability. Even up to the 1980s and early 1990s, the majority of Western economists and economic commentators predicted that the rapidity of the Chinese economic growth would not last long. However, unlike this skeptical outlook, the unprecedented economic growth performance of China has been continuing for over 30 years. Moreover, as shown

through financial crisis, it has even proven that the Chinese economy is not only stable but also relatively immune to external impact.

The third characteristic shown by the economic growth of China is the fact that the role that technological progress has played in the economic growth is relatively large. In theory, the economic growth factor could be broadly divided into the increase in inputs of physical factors of production and improvement of productivity by technological progress, the latter of which is called total factor productivity. In practice, according to recent studies (Bosworth and Collins 2003, 2007), total factor productivity of the Chinese economy between 1978 and 2004 grew annually at 3.8% on average which was an unprecedented level in the world. This means that the growth of the Chinese economy greatly depends on the technological advance and the consequent improvement of efficiency, but not the simple increase of factors of production (see the last column in Table 2). The phenomenon of economic growth led by technological advance is a factor which differentiates China from other East Asian models and suggests the sustainability of the economy. Indeed, while the growth rate of fixed capital was much higher than the rate of technological progress in the case of East Asian economies, it appeared that the technological progress rate was higher than the fixed capital growth rate in the Chinese economy. In addition, another study (Jeon 2008) empirically shows that the Chinese economy had achieved a significant level of economy of scale.

Table 2. Growth Accounting for East Asia and China, 1978–2004(Annual Growth, %)

Period	Output	Employment	Output per worker	Contribution by			
				Physical Capital	Land	Education	TFP
China							
1978–2004	9.3	2.0	7.3	3.2	0.0	0.2	3.8
1978–1993	8.9	2.5	6.4	2.5	–0.1	0.2	3.6
1993–2004	9.7	1.2	8.5	4.2	0.0	0.2	4.0
East Asia (Excluding china)							
1960–1980	7.0	3.0	4.0	2.2		0.5	1.2
1980–2003	6.1	2.4	3.7	2.2		0.5	0.9
1980–1993	7.3	2.7	4.6	2.6		0.6	1.4
1993–2003	4.5	2.0	2.5	1.8		0.5	0.3

– Source: Collected from Bosworth and Collins (2003, 2007)

The overall figures of an economic-political system of China that outstanding achievements have relied on is carefully named ‘Beijing Consensus’ by political economists.¹⁾ In origin, this

notion was first advanced to contrast it against the current world-dominant idea of the so called 'Washington consensus' led by Western mainstream economists and world institutions such as IMF and World Bank. However, the initiative concept has not been formalized and its reality was not fully analysed yet. The present paper is to fill this gap. By reviewing the Chinese development process, this study aims to contextualize the challenges the Chinese socio-political system faces in a historical perspective. This will enable us to prospect the long-term trajectory of the future development of China.

II. Political Economy of the Reform in China

1. The Reform Got Started

The economic development that China has achieved during the reform period differs greatly from those of transitional economies of Eastern Europe. Contrary to the case of China, the post-Socialist economies of the Soviet Union and Eastern Europe have experienced severe decline in production and economic fluctuations since launching reforms, and are not showing clear results up to the present.

The difference in such outcomes could be explained by the difference in transition strategies adopted by the transitional economies, which is often called the Big Bang approach.²⁾ The advocates of this approach argue that the legacy of the planned economy must be eliminated as soon as possible, and that market elements such as private property right, liberalized price, and deregulation must be adopted over all parts of the economy radically and rapidly. The Big Bang approach is based on the belief that resistances to reforms from the vested groups under the old regime could be neutralized through irreversible reforms that are based on firm trust in the efficiency of the market. Regarding the reform of China, the advocates argue that the outstanding performances would be attributable much to the initial conditions favorable to reforms rather than gradual reform policies that are believed by many to be pursued by China.

In contrast, the gradualists claim that a gradual and incremental reform strategy, rather

1) After this term was first advanced to emphasize the unique development strategy that China has taken (Ramo, 2004), the concept has been even expanded to explain the political reaction from the third world and how it affects ongoing structural change of world political power (e.g. Arrighi, 2007; Halper, 2010).

2) For the big bang approach, see, among others, Lipton and Sachs(1990), van Wijnbergen(1992), Krueger(1993), Sachs and Woo(1994), Woo(1994); for the gradualist approach, see Murrell(1991), McMillan and Naughton(1993), Qian(2003), Putterman(1992), Griffin and Khan(1994).

than favorable initial conditions, played the critical role in China's success. The reform strategy adopted by the Chinese government was not a deductive method based on a certain theoretical position preoccupied *a priori* but a more flexible and pragmatic one based on the economic and political environment of China at the eve of its reform. Therefore, in order to properly understand the reform strategy of China, there is a need to understand the objective conditions under which China was laid at the time.

At the time when China began the reform and open door policy, the objective constraints can be broadly divided into economic conditions and political conditions. The first economic constraint was the fact that a relatively big non-state sector existed in China compared to the former Soviet Union or other planned economies. In 1978, employment of the state sector took about 24% of the total workers in the country and about 78% in the cities (In the case of the former Soviet Union, in 1988 when the reform began, it was about 88% as a whole nation and 96% in the cities). Although the fact that a big part of the economy was not integrated into the state sector worked as an unfavorable condition in running the planned economy, it turned out to be a favorable condition after the goal of transitioning to a market economy was set. As a matter of fact, the Chinese reform was to maximize the economic performance by adopting policies which could actively expand the non-state sector. In other words, by actively promoting the growth of the non-state sector, the Chinese economy was able to pursue the stable growth of the market economy while avoiding the chaotic disruption that might well be caused by radical privatization.

This incrementalist approach (an approach with a meaning to not break up or restructure the existing production sector but improve the overall production by fostering a new sector outside the existing realm) that China adopted as the reform strategy has been proven to be a very effective strategy in the following three points. First, the industries newly grown out of the existing planned economy contributed most significantly to the economic growth in China. The employment absorbed by Township and Village Enterprises (TVEs) has grown annually at 9% between 1978 and 1996, from 28 million in 1978 to 135 million. In terms of the production of value added, despite the fact that the GDP was growing rapidly with an annual average of 10.1% between 1978 and 1996, the share of TVEs in the GDP grew from 6% to 26% during the same time period. Second, the non-state sector which grew outside of the plan greatly contributed to establishing the competition system of the entire economy. As the non-state sector which became the new growth engine took off as a important element of reform, it was run under market principles from the beginning. During the initial stage of the reform in which these sectors just began growing, it could only grow by playing a supporting role to state sectors. However, as the non-state sector grew rapidly, it started competing against the planned sector, and this provided a powerful force to introduce the

market principles to the state sector. In other words, as the enterprises growing outside the plan adopted the market principles of competitiveness and profitability as their management principle, even the state sector that had to compete with these enterprises now had no choice but to accept the same principles. As a consequence, the strategy growing out of the plan can be said to have greatly contributed to introducing the market principles to the entire economy including the planned sector of the past. Third, by not dismantling the existing economy disruptively, this strategy was able to obtain extensive public support. This is the phenomenon that is sharply contrast to the case where the former Soviet Union and Eastern Europe countries adopted the strategy of dismantling the existing system and reorganizing it into a new system overnight. In fact, the process of disbanding the existing system could only be completed inevitably by producing victims of the reform, and these people became a force which actively resisted or passively did not cooperate with the reform. However, China's strategy which maintained the existing economic sectors and grew independently outside of that system was able to minimize the damage due to the reforms. For instance, the growth of the non-state industry was not damaging the benefits enjoyed by the workers employed in the existing state-owned industries. Just as the growth of the rural industry showed, this could improve the income and living standard of the public by creating a new income sources. Therefore, China's reform strategy is sometimes called 'reform without losers' (Lau, Qian, and Roland 2000).

The second economic condition given at the point of time when China began its reform was the fact that the country was very decentralized. From the context of the first economic condition discussed above, this implies that even under the past planned economy, provinces were not tightly planned and controled by the central government and were largely given relatively high autonomy in various levels of the administrative hierarchy. On the other hand, decentralization also implies that a relatively diverse range of industries are evenly distributed throughout China rather than a specific industry is specialized one region by another.³⁾ To turn this condition a positive, the central reform policy was to actively utilize the provincial governments. The central government organized the public finance system in order to secure stable central tax revenues, and by having the rights to appoint provincial officials, it established a political system that can monitor and supervise the regional governments. Furthermore, the central government had provincial governments support non-state owned enterprises located within their jurisdiction and the growth of the regional economy (for more details, see Montinola, Qian, and Weingast 1995; Walder 1995; Oi 1999). Regional officials were given a motivation to expand the regional income through the growth

3) Qian and Xu(1993) call an economy with this type of industrial distribution pattern M-type economy and designate the former Soviet Union and Eastern Europe block as U-type economy.

of the non-state owned enterprises in that region, because it not only was an important basis for promotion of the officials but also provided the financial sources that would further develop the regional economy.

The condition of decentralization provided another opportunity for the Chinese economy. This meant that the reform policy could be spread through experiments. The reform of China set the priority of reforms and reformed everything one at a time rather than trying to change all of the past planned economy overnight as the radical reformists argued. A good example of this strategy is the fact that China first started reforms in the agricultural sector rather than the industrial sector, and gave the higher priority to the real sector over the financial sector. Moreover, it did not hastily try to deny the inheritance of the past in the reform of each sector, and it followed a pattern in which both old and new elements coexisted for some time while introducing a new system as the existing system was maintained. This so called 'dual-track system' was to buy time for the new system to gradually adopted and to also secure the opportunity to correct problems in the new system. Such dual track system first appears in the relation between industries: it was the coexistence of the planned sectors and unplanned sectors. Furthermore, such dual track system was introduced even within the same industry and the same adjustment mechanism. For example, the key operating mechanism of the market economy is the price system. However, China tried to maintain the coexistence of planned prices and market prices instead of immediately replacing the holistic market price on all products.

This dual track system was introduced even to the process of spreading the reform policies to provinces. Under the given situation of decentralization defined earlier, the reformers in China tried to find the most suitable policy according to the characteristic of the relevant region rather than adopting a uniform regional reform policy, as it was believed that this was the most realistic and pragmatic approach. Even in the case of TVEs which developed the most dynamically, the fact that its constituents and operating principles were very diverse becomes an important example of this strategy. This pragmatic approach inevitably gave birth to the notion of 'Experimentalism.' Because the policy mistakes believed that reforms may give rise to a bigger problem in a situation where there are no knowledge about the procedures of reform and its long term effects when reform is implemented to the entire nation (Roland 2000), Chinese reformists first experimentally introduced new systems that they had formulated into specific regions or specific industries. Only when this was proven successful, this new system could be modeled after or spread to the entire industry or throughout the country. Even if the experiment fails, its damage is limited to experimental industries or regions, and this has the advantage of being able to minimize the disruption from reforms. However, the important point is the fact that what made this experimental

reform procedure possible was because the situation of China at the time was decentralized and was maintaining an economy in which industries were distributed relatively evenly over regions.

Turning to political aspects, the economic reform strategy listed above was a strategy very much in line with the political conditions or, sometimes, constraints that China faced at the time. The political conditions at the time when China launched its reform package are summarized into the following four dimensions. First, as well expected, the conservatives within the communist party who tried to maintain the old system strongly resisted the market-oriented reform. The Chinese political leaders were divided into the reformist and conservatives. Since the failure of the reform provided the conservatives the excuse to immediately strike back reformists, the reform policies had to be carried out cautiously. From this point, the gradualist's incrementalist approach through experiments was a strategy suitable for effectively overcoming such political constraint. This was also coinciding with the political strategy that they could take one step back when the resistance of conservatives is fierce and will take two steps forward once the situation gets better by acquiring the support from the public regarding the reform. Second, the public was tired of the economic backwardness, which had been stagnant under the socialist economy. As acquiring such support from the public was the most important condition in overcoming the resistance of the conservative forces, it can be said that improving results through reforms and distributing the results to the public was the most important task at hand to success reform. From this perspective, 'reform without losers' resulting from the incrementalist strategy was more than enough to obtain the support of the public. The third condition was that China was maintaining a political system where one communist party was ruling the country at the time and the present. However, this centralized power worked as a positive factor by enabling to force effectively the provincial officials to promote the growth of their regional economy. Fourth, the extent and direction of the reform desired at the each level of regional government was relatively different. Instead of ignoring their wants and needs by inducing a holistic rapid reform policy, the reform strategy of China exerted efforts to reflect the interest of each region as much as it can through decentralization.

In the end, the characteristics of the reform strategies adopted by China during the first phase of reform between 1978 and the mid-1990s can be summarized into the following four points. First, China's reform strategy thoroughly took into account the economic and political conditions given objectively at the time when it began the reform. Second, China's reform strategy was based on experimentalism which spread the policies to the entire nation after partially experimenting the new order in an incremental way from outside of the existing planned sector. Third, China's reform strategy was decentralized, meeting local specific

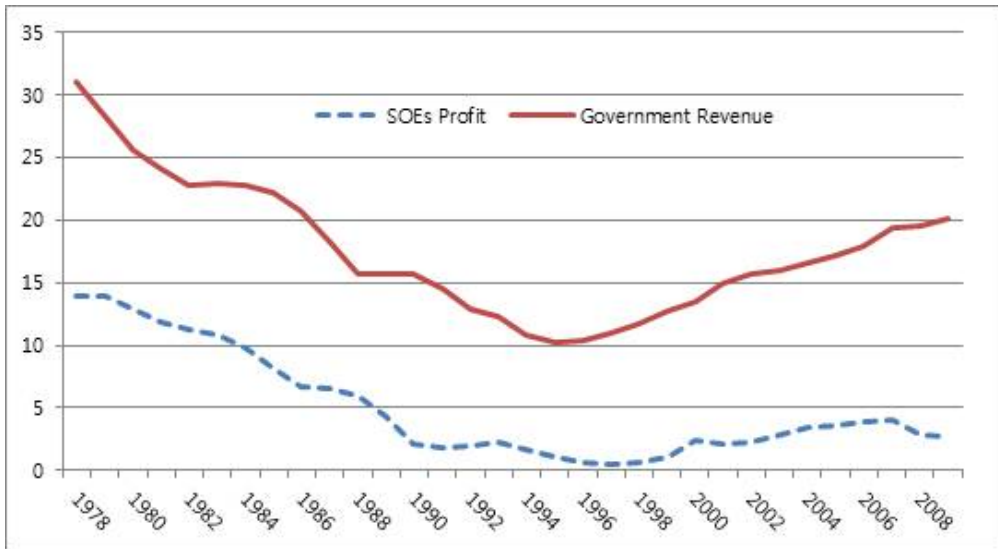
desires. Finally, but most importantly, rather than fostering chaos and victimized groups due to reforms, it shared the positive effects with the public and won political support from them, and through this, the country was able to overcome partial resistance against the reform.

2. Things Changed

Despite the numerous positive results produced by the reform policies carried out up to the early 1990s, such strategies could not be sustained for the long time. The heart of the reform policies carried out during this period was to maintain a stable system and discover a new growth engine while not damaging the vested interest of specific groups under the existing system. However, the coexistence of prerogative interest group, the stability of the system, and continuous growth could not continue. Among the remains of the existing planned economy, the most important part which was maintained was the state owned enterprises (SOEs). As the economy grew, however, their very existence was threatened. The crisis of these SOEs was a natural result of the simultaneous workings of internal and external factors. First, as the internal factors, SOEs were still under 'soft budget constraints' which does not hold financial responsibility for its own managerial decisions. Although there were some autonomy and responsibilities given to these enterprises during the first reform period, most of their profits were transferred to the state's budget, and there were no changes in the fact that their loss was also appropriated as the budget of the state. Therefore, the decision-making principle of the managers of SOEs tended to be heavily influenced by other factors rather than profit made by their firms. The most important factor determining the financial profitability of SOEs was the social functions that they were in charge of. SOEs had to guarantee the lifelong employment of the employed workers regardless of the market conditions in which they were actively engaged in. Furthermore, they had to provide social security services such as housing, medicare, child education, and pension to the employed workers and their families. Due to this internal issue of being the enterprise in charge of such social functions, the profitability of SOEs steadily declined.

Secondly, the external factor which threatened SOEs' financial profitability was the intensified market competition. From the beginning of the reform, the strategy of pursuing growth from outside SOEs promoted the emergence of non-state owned enterprises that can compete against SOEs later. SOEs were maintaining a relatively low competitiveness against these new competitors, especially, the TVEs and foreign-funded enterprises due to its own internal factors pointed out above. As a result, their financial profitability declined even further.

Figure 1. Government Revenues and SOEs Profit (Percent of GDP)



- Source: *China Statistical Yearbook 1997-2010*

The decline of the profitability of SOEs gave birth to many negative secondary ripple effects which were at the event expanded throughout the economy. First, the decline of the profitability of SOEs led to the drop in budget revenue of the central government. The reforms during this period were led by the government financing the required cost of the reform processes. For instance, as the first stage of the agricultural reform during the initial phase of the reform, the government raised the price of procurement grains. But to make sure that this price increase of agricultural products does not carry over into the reduction of purchasing power of the urban labor workers, the government took the entire burden providing subsidies related to the food price increases. If there had been no injection of such similar finance to other sectors, victims due to the reform would have been produced in large numbers. However, in addition to sharing budget system with provincial governments due to decentralization, the decline of the profitability of SOEs which had been serving as the major source of government budget revenue worsened the budget constraint of the central government. Moreover, the weakening of the government's financial capabilities was about to greatly weaken the government's capacity to coordinate and carry out the reform, and this had the possibility of putting the reform itself in jeopardy.

Table 3. Short-term lending by China's national state banks to various sectors, 1985-2003(%)

	SOEs	Foreign-funded Enterprises	Private and Individual Enterprises	TVEs	Others	Short-term loans as % of total loans	Share of SOEs in Loans for Fixed assets
1985	93.7	-	6.3		-	81.3	78.1
1990	93.0	-	7.0		-	78.2	79.6
1997	81.1	3.9	0.4	3.5	11.1	74.6	65.8
1998	80.4	4.7	0.4	3.7	10.8	70.3	65.3
1999	77.6	5.3	0.6	3.8	12.7	68.0	65.0
2000	71.8	5.4	0.8	2.9	19.1	64.5	62.2
2001	80.7	5.5	0.9	3.3	9.6	54.4	57.3
2002	78.4	3.8	0.8	3.3	13.7	50.4	-
2003	75.0	3.5	1.1	3.5	16.9	45.2	-

Source: McIver(2006, p. 208)

Table 4. Non-performing loans by banks (% of total loans)

	State-owned	Non-bank financial Institutions	Rural Credit Cooperates
1994	20		
1995	22		
1996	-	50	38
1997	25		

- Source: Lardy(1999)

The second negative result from the decline in profitability of SOEs was the worsened solvency of banks greatly threatening the stability of the Chinese financial sector. Up to then (or even up to now), in China, the banks usually owned by the government played the most important role of providing credit to SOEs. As of the end of 1998, the 4 major state-owned banks took 62.5% of the total credit of the Chinese economy. Among these, providing credit to SOEs exclusively took the largest share. During the same year, the short-term loans to the SOEs took 80.4% of the total loans made by state-owned banks, and 65.3% of the fixed asset investments of SOEs was made by the borrowings from state owned banks (See Table 3 and 4). In other words, Chinese banks were tied up to the task of providing credit to SOEs, which were usually guaranteed by the government or by the administrative order of the government. This was the measure taken by the reformist government to maintain the

stability of the existing system. Therefore, the credit distribution of banks was carried out by not the profitability criterion of enterprises (borrowers) such as future cash flows or the borrowing enterprise's ability to redeem but by the administrative control of the government, and even if the enterprise receiving the loan made losses turning it into a bad loan, it was not the responsibility of the bank. In fact, these concerns were realized when the profitability of SOEs gradually worsened. The moral hazard of both the banks and SOEs especially resulted in a large amount of non-performing loans and increased the instability of the financial system.

In order to solve these problems caused by the reform strategies adopted in the first phase of the reform, a new strategy emerged starting from 1993. The goal of the modified strategy was to abolish the dual track system, and to create a rule-based regulatory environment or a 'level playing field' by creating laws and rules that were to be fairly applied to everyone. For example, there were different rules being applied in taxation and scope of business between SOEs and TVEs in the industrial sector. Such distinction was due to the strategies adopted during the first phase of the reform, in which new rules were introduced to the new sectors growing outside of the existing system whereas the old system (while there were some modifications) were continuously maintained and generally succeeded as it were. As pointed out earlier, the decline in profitability of SOEs caused various ripple effects, and the cause of this was from maintaining the social (security) function of SOEs and the manner that they were managed by political logic rather than market principles. Moreover, the pressure of competition from the sector growing outside the planned sector that fostered their competitiveness under pressure of the market principle under the new rules, implied that the existing remains of past could not survive on the old principle any more. Therefore, the newly conceived reform strategies are summed up as a process of clearing past legacies. That meant that even the protected planned sectors had to be operated under the same rules as the more competitive market sectors. For this, the existing protective measures were dismantled and integrated into a new system, and as a result, SOEs and non-state owned sectors started competing fairly under the same set of rules.

The reforms characterizing the second phase of the reform were especially noticeable in the following four facets. The first move was corporatizing SOEs under the Company Law passed in 1993. This law was applied to all enterprises including SOEs, and made all enterprises work within a uniform legal and regulatory framework. However, the legislation of this law had a greater implication for the existing SOEs. First, as the social responsibility as well as the protective system for the SOEs disappeared under such consistent set of rules, these firms were further exposed to competition and had to face the rules of the market. Now SOEs were more sensitive to profitability leading to massive restructuring that

in turn ended up with massive layoffs to eliminate inefficient parts and cuts in welfare benefits of employees.

Second, the reform on the tax and fiscal system was carried into effect. Regarding the previous tax system, tax bases and tax rates were set differently according to the ownership type of the enterprise and their respective needs. However, the new tax system effective from January 1, 1994 evenly applied uniform tax bases and tax rates to all types of enterprises. This was to abolish the enterprise-specific profit favors in the past and to integrate them into the value added tax and profit tax, which was consistent to the spirit of the Company Law. In addition, a new central-local fiscal relation was introduced between the central government and local government. The key point here was the new measure to divide the tax items between the central government and the local government. By doing so, it eliminated burdens that the local government had imposed on rural enterprises in various forms and allowed them to follow the new tax rules set uniformly. In this sense, the tax and fiscal reform also conformed to the principle of the rule-based regulatory framework. As a result, the budget revenue of the central government increased, and through this fiscal capacity, the government was able to strengthen its ability to redistribute revenue among regions and recover its authority for putting the reform policies forward.

Third, as of January 1, 1994, China discontinued the dual track system for foreign exchange rates and unified it into unique one. Accompanied by the reform of the foreign exchange rate system, foreign trade was more comprehensively liberalized than ever before. The single foreign exchange rate system adopted the market exchange rate which relatively devalued yuan (the Chinese currency) as its official exchange rate. This devaluation of the yuan became the precondition for the latter liberalization of foreign trade and boosting exports.

Fourth, the banking system was drastically restructured. Starting from 1995, the Chinese banking system went into a thorough restructuring process. Although the People's Bank of China(PBC) was nominally established as a central bank in 1983, it was not able to break away from the control of government officials from both the central and provincial governments even up to the early 1990s. However, following the restructuring plan at the end of 1998, all the PBC branches installed in each province were shut down and 9 regional PBC branches just like the Federal Reserve Board system in the US were newly established, with the result of preventing the intervention of the provincial governments. Consequently, the People's Bank of China ultimately established its organizational structure that can function as a central bank, and the central bank redefined its major role as the macroeconomic policy playing its leading role for determining and carrying out monetary policies with the Monetary Policy Committee, established as an operation and advisory body.

As a result, state commercial banks faced a much harder budget constraint. This strengthened market discipline was carried over to state enterprises, its major customers: that is, even SOEs were led to hard budget constraints. Likewise, in order to force market disciplines to banks, they had to solve the hot potato of the past burden, namely, the bad and non-performing loans of state banks. To take care of this, 4 asset management corporations were established in 1999 with major task to take over and deal with the non-performing loans from 4 major state commercial banks. Furthermore, the supervisory function of the People's Bank of China was separated to strengthen the supervision on banks and the China Banking Regulatory Commission(CBRC) was newly founded on April 2003.

To sum, despite the difference in specific policies taken for each area of the economy, the goals and strategies during the second phase of the reform pursued since the mid-1990s was to provide a consistent and rule-based regulatory framework for a level playing field and to step up more intensive competition, instead of randomly responding to each issue, by applying the same set of market rules to all the major players of the economy.

III. Challenges: Social Integration

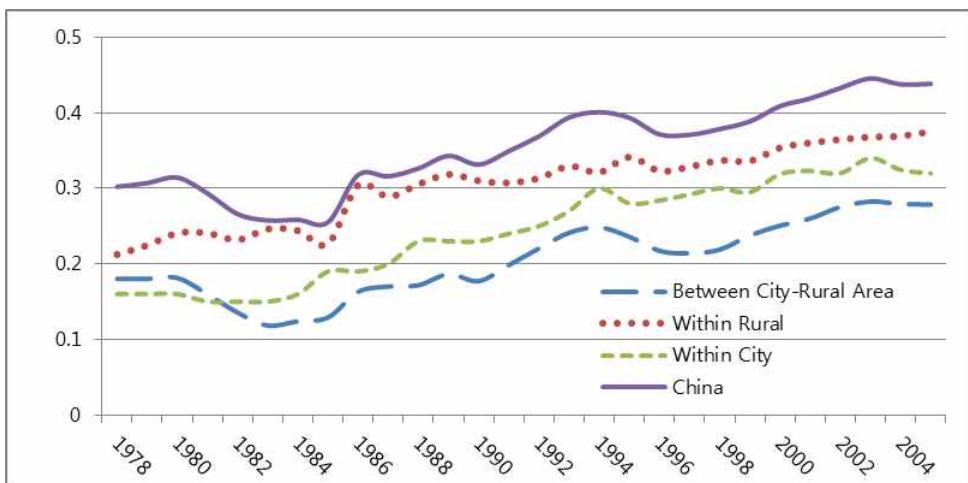
1. Income Inequality and Social Conflict in China

It seems that during the first stage of the reform in the early 1980s, the achievements of the Chinese economy were distributed relatively evenly to Chinese individuals. Looking at the degree of income inequality measured by Gini coefficient since the late 1980s, however, it appeared that income inequality has risen within the city, within the rural area, between the city and the rural area, and China as a whole (See Figure 2).⁴⁾ First, the Gini coefficient on the entire China increased by about 1.5 times between 1978 and 2005, implying that China's income inequality has worsened considerably. Second, it appeared that the Gini coefficient grew by 17% within rural area, 100% within cities, and 45% between cities and rural area during the same period. In other words, inequality is increasing very rapidly within cities. Third, the increase in income inequality within cities is making more and more contributions to the increase in income inequality of the entire nation. While the effect that the changes in Gini coefficients within the city has on the increase of Gini coefficient of the entire nation increased, the influence of the Gini coefficient for rural area gradually declined. Out of the

4) The discussion on the evolution of Gini coefficient here draws on Chen *et al.*(2008). See also Benjamin *et al.*(2008).

total changes in the Gini coefficient for the entire nation, the contribution made by Gini coefficient for rural areas significantly dropped from 49.83% in 1983 to 14.21% in 2005. On the other hand, that of cities grew from 3.41% in 1978 to 22.23% in 2005. Fourth, the factor having the greatest influence in the worsening of inequality in China as a whole through the entire period was the income inequality between cities and rural areas. In fact, such gap between cities and rural areas accounts for 50% of Gini coefficient of China in 1985 and 63.56% in 2005. These findings imply that the most important factor explaining the income inequality in China is the gap of economic growth between regions. In short, the income inequality which used to decline steadily during the first phase of reforms has increased since the mid-1980s, and it explains that the income inequality between rural areas and cities took the largest part in the increase of income equality in China as a whole (Chen *et al.* 2008).

Figure 2. Income Inequalities in China: Gini Coefficients



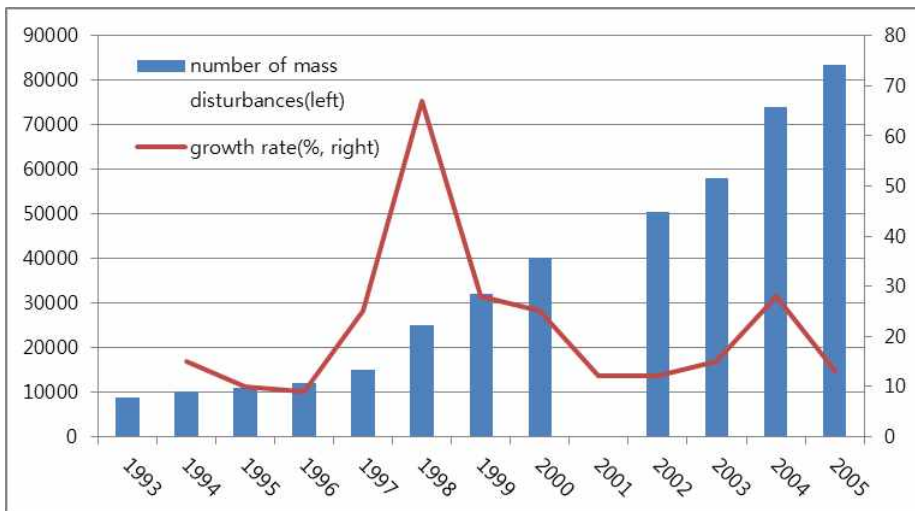
Source: Graphed from the figures in Chen *et al.*(2008), Table 2.

Reflecting such increase in income inequality, the complaints of the Chinese people also rose significantly. According to the official statement of China, the number of mass disturbances defined by riots by more than 15 people was even less than 10,000 in 1993 but it has increased by about nine fold in 2006. But these riots are not organized into large demonstrations nor does it have some kind of political direction like the Tianmen Square Incident. These riots are in the form close to a sort of a group protest mostly consisting of complaints on farm price policies, migration issues between cities and rural areas, excessive tax collection on farmers, loss of farm land, and corruptions of government officials (Turzi 2008; Keidel 2006). However, the rapid rise in public riots requires attention because it shows

the conflict and splitting of the Chinese society.

The most important cause of social conflict in China is, above all, the income gap shown above, and among these, the gap between the city and rural area. However, such gaps cannot be concluded as the result from the reform *pe se*. Instead, it should be considered in terms of the type of reform taken. In reality, the reforms during the 1980s resulted on average in about 10% annual growth of the economy while not significantly increasing the gap in income. The trend was reversed when a package of radical reform policies were introduced after the mid-1990s. Therefore, the period in which such gaps occurred is the period of the radical reform period starting from the mid-1990s. The factors that had the greatest effect on social inequality can be identified as the following three changes.

Figure 3. Mass Disturbances in China, 1993–2006



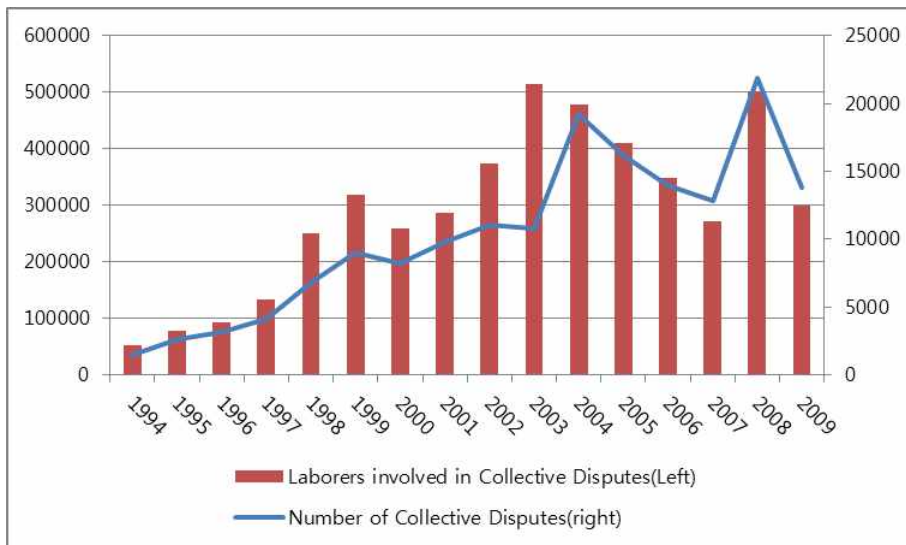
Note: A mass disturbance is defined as a rally involving 15 people or more.

Source: figured from table on Keidel (2006), p.3

The first factor is the restructuring of SEOs and the mass production of unemployment. The reform of Chinese SEOs had a significant effect on labor relations. The core of the reform in the employment system of China during the 1990s was to overcome the harmful effects of the lifetime employment system on SEOs and to expand the flexibility of the labor market. This reform, on the one hand, weeded out surplus labor and accelerated the switch over to a labor contract. As a result, during the 4 years between 1996 and 1999, over 7 million workers were laid off every year on average. Since then, although reemployment programmes were set by local governments and unemployment subsidies were provided immediately, most of the workers were at the end absorbed into temporary positions in the

informal sectors with less payments. When considering the social functions that state enterprises were responsible for in the meantime, the reform of these state enterprises also meant the weakening of the social security system. The burden on an individual workers regarding public services such as medicare, taking care of the aged, and education greatly increased. Therefore, it would be safe to conclude that the radical state enterprise reforms and labor market reforms carried out after the mid-1990s made employment unstable, and dropped the living standard of urban workers by cutting social security services. An aspect of such results can be seen from the trend of the collective labor disputes which grew steadily since the mid-1990s (See Figure 4).

Figure 4. Collective Laborer Disputes in China, 1994-2009

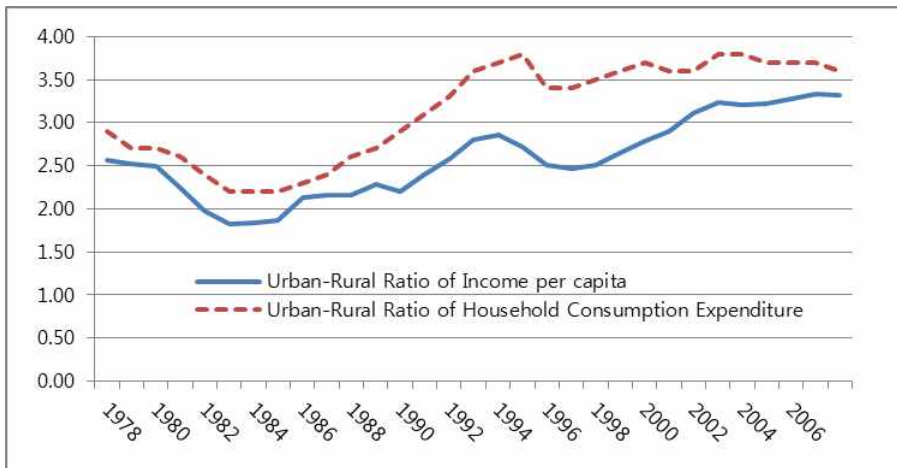


Source: *China Statistical Yearbook*, various years

The second factor expanding income gaps and social conflict in China was the household registration system (*hukou*) which limited the migration of farmers into cities. The tradition of restricting farmers from moving to the city was the product of the economic growth strategy during the socialist period. During the socialist period, China adopted the growth strategy of giving the top priority to developing heavy industries, and this was an economic growth strategy which required a large capital-intensive investment. Mobilizing resources from the agricultural sector which took the largest share of the Chinese economy at the time was the best way to obtain necessary investment resources within the country when there was almost no foreign transaction. Rural areas were forced to make sacrifices for (urban) economic growth, and to do this, it required a policy for maintaining a stable agricultural

economy by suppressing the migration of the population. For this reason, the policy was enforced that farmers were distinguished from city residency (*hokou*) and separately and strictly forbidden from changing their *hukou* status. For instance, under the household registration system in China which made sure that anyone without city *hokou* can not enter the work unit in cities, farmers were actually prevented from leaving out of a rural area to move into a city.

Figure 5. Ratio of Urban-to-Rural Household Income and Consumption Expenditure



Source: *Statistical Communique of the PRC on the 2008 National Economic and Social Development*, and *China Statistical Yearbook 2010*, National Statistical Bureau

Figure 5 traces the long-term trend of the gap of income and consumption expenditure between urban and rural households. As it shows, the household income gap between the city and rural areas were already very wide when China began its reforms in 1978. The per capita income of urban residents was 2.6 times higher than rural area residents. However, during the initial period of the reform, the gap between the city and rural areas temporarily declined while farmer's income significantly increased. However, this gap began growing wider again from 1984. Nevertheless, even up to 1992, this gap was still narrow compared to 1978. The rapid economic growth concentrating on the cities during the 1990s gave birth to a new aspect of polarization. This gap was reduced during the short period between 1995 and 1997, but this was mainly due to the surge of the market price of agricultural products. But high price of agricultural products did not last long, and the gap between the city and the rural area grew steadily between 1998 and 2008. As of 2008, the income per capita of cities is 3.31 times higher than that of rural area.

In the meantime, the per capita income shown above is just an index showing the

difference between the actual living standards of cities and rural area. Because the restriction in relocating to the city means that farmers are excluded from comprehensive social services provided by the work units in cities, the distinction of *hukou* between the farmers and city residents implied a systematic discrimination against rural residents. In fact, the social security services provided by the state sectors in cities were exceptionally higher than those in rural areas. Moreover, the reforms since 1978 first began from rural areas and had broken down the rural collectives, the basic organization of the rural area, in a radical way. Although it was less than the services provided by the work units in cities, the rural collectives in rural areas had also provided social services such as medicare and basic education to farmers. However, due to the collapse of the rural collectives, even these basic social services in rural areas were discontinued. Therefore, the fact that the state sectors were still at large in charge of social functions in the cities until the 1990s implied that the actual gap in living standards between cities and rural areas was much wider than the difference measured by the monetary income per capita.

The third major factor explaining the increasing income inequality and social conflict in China is the geographically unequal growth strategy. The first geographical inequality is the result of different treatment on cities and rural areas. In other words, due to the growth strategy giving priority to the development of urban industry as one of the growth strategy of China, discriminative policies were enforced on rural areas. Even among the causes of public riots, there are a lot of reports that those are resulted from this kind of discriminative growth strategies on rural areas. For instance, there were many reports of improper compensations to farmers when the (local) government expropriate land in order to expand (urban) industry-related facilities or instances where conflict arose when development is carried out while not properly reflecting the demands of farmers in the relevant area.

The second aspect of the geographical inequality in China besides the segregation of the cities and the rural areas appears between the fast-growing Eastern coastal regions and the relatively stagnant inland areas. According to the 'Getting Rich First theory (先富論)' by Deng Xiaoping which states, "The eastern coastal areas must be developed first using its favorable elements and once the East reaches a certain stage of development, the development of the mid-west regions must be accelerated," China's open door policy was launched by granting special privileges to the eastern coastal areas, and the benefit of economic growth due to this policy has been concentrated in this region only. For example, the open door policy started off by installing various special economic zones in the eastern coastal areas. The special economic and technological zones installed aimed to increase foreign direct investments and foreign trade. For this, various special benefits not applying to mainland China and inland areas were provided to foreign investors in this region such as tax reduction or exemption,

administrative conveniences, and permission of foreigner's access to the domestic market. This actually proved to be a very successful strategy. That is to say, foreign direct investment not only concentrated in this area, but this region definitely took up a large share in China's overall foreign trade. This was because foreign investment companies played a leading role in exports. As a result, the economy of the coastal area grew at a very rapid pace and widened the income gap with the inland.

The rapid growth of the Chinese economy accompanied many inequalities that can give rise to social discord. The factors of such inequalities include the mass production of the unemployed from the rather drastic reform in the state owned sector in cities, discrimination between the cities and the rural areas, and geographically, the widening of the regional gap between the eastern coastal areas and the inland. As a result, China's social unrest is gradually increasing, and this issue which must be solved will emerge as one of the greatest challenges to the sustainable growth of China.

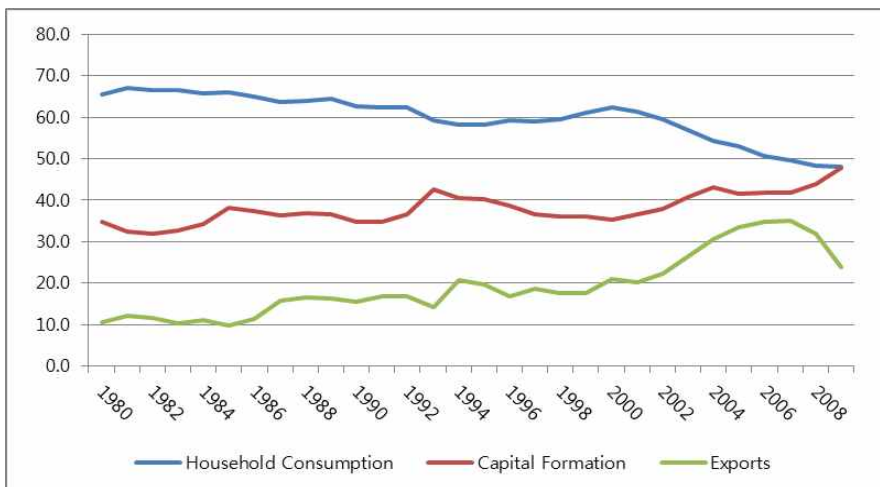
2. China's Response

Likewise, while China's reform and open door policy achieved a rapid economic growth, it also caused problems including the increase of the unemployed, reduction of social welfare, widening of gap between cities and rural areas, and uneven growth among regions. This inequalities and internal imbalances may be an inevitable process appearing when an economy grows. However, as the dark aspect of economic growth gradually expands, the discontentment of the Chinese are rising and manifesting itself with rising troubles by labor workers and farmers, and is threatening the sustainability of the Chinese economy from a social aspect. The top leaderships of the Chinese communist party was aware that such rising social conflicts and disorders can significantly threaten social instability, and have adopted a new motto of economic growth, the so called 'construction of a harmonized society(和諧社會)' and 'balanced growth' at the end of 2004, and this was embodied as 'The Scientific Concept of Development' in 2005. Therefore, the major point of this new growth strategy is filled with the response measures that can alleviate social conflicts in China.

The slogan (or theory) of a harmonized society became the key national challenge of the Hu Jintao administration. The heart of the harmonized society policy can be summed up into balanced growth strategy and conflict management. First, there are specific policies in effect to narrow social gaps in order to manage social conflicts and disorders. For example, through expanding the liberty to migrate, the Chinese government is expanding the rights and interests of peasant workers who are alienated from the city even though they have

moved from the rural areas and are living in the city. Furthermore, the administration is trying to improve the stability of employment and rights of workers through introduction of the new labor contract act from 2008. Second, the balanced growth strategy is appearing as the Great Western Development Program, Northeast Rehabilitation Plan, and construction of social overhead capital(SOC) for rural areas. Especially, the 3 major agricultural issues (farmers, farm, and agriculture) are the obstacles preventing social stability. Along with the western development plan, the central and provincial governments strongly enforced policies such as support of agricultural developments, improvement of farmers' living standards, and eradication of poverty in order to solve the 3 major agricultural issues. As a result, there are signs that the 3 major agricultural issues are easing off to some extent, and the foundation of agricultural growth is gradually expanding. Moreover, conditions for industrial development and urbanization of rural areas were created with the formation of a large rural SOC. Even in recent times, the Chinese government is concentrating on the development of rural areas, and is still exerting much effort in solving the 3 major agricultural issues. In a sense, the economic details in constructing a harmonized society are focusing on alleviating the major inequalities such as improving the regional inequality, prohibition of discrimination between cities and rural areas, guaranteeing income of urban families, and improvement of the rights and interest of workers.

Figure 6. Components of GDP in China, 1980–2009 (%)



Source: UN *National Accounts Statistics* and *China Statistical Yearbook 2010*

This inequality easing strategy is closely related to easing of imbalance issues of the global economy in relation to China in the sense that it coincides with the idea of switching over from an export-led growth to a domestic consumption-led growth regime. Recalling the

previous discussions on the reform process, the characteristic of the reforms until 1992 can be identified by the rearrangement of surplus labor into labor-intensive sectors, and compensations on labor grew in proportion along with economic growth. This economic growth pattern can be called 'the reform without losers' from the context of social stability, and as a result, economic growth was usually supported by the increase in total labor wage and demands for consumption. Figure 6 shows the trend of the share of the domestic consumptions, investments, and exports as the share of GDP. It shows that, while the growth rate of GDP reached even over 10% throughout the 1980s, the share of the domestic consumption is maintaining a stable level of over 50%. The fact that GDP increased rapidly and the domestic consumption followed the generally similar pattern implies that the economic growth in China during this period was a demand-led economic growth in the sense that the growth of GDP was dependent heavily on domestic consumption, and the increase in consumption could be explained best by the direct result of increasing absorption of surplus labor rather than the increase of wage rates. In contrast, although wage rates increased to some extent as a result of a more drastic reform after the mid-1990s for the goal of improving efficiency, the overall domestic income was reduced as the decline in total income due to rising unemployment exceeded the increase in income from higher wages. As the result, the share taken by domestic consumption dropped sharply.⁵⁾ The expenditures substituting the declining domestic consumption were investments and exports. As can be seen from figure 5, the share of domestic consumption and investment are accurately moving in the opposite direction. Especially, while the share of domestic investments dropped from 1993 to the early 2000s, the fact that exports grew explosively shows that the more important part substituting domestic demands was exports. Therefore, even though there have not been big changes in the GDP growth rate of the Chinese economy, the internal structure and characteristics which spurred its growth have been dramatically changed between the two periods.

However, sacrificing domestic consumption substituting it by increased exports increased the vulnerability of the Chinese economy to the changes in the foreign economy. The 1997-8 Asian financial crisis became an important turning point for strengthening this awareness to the Chinese leaderships. Moreover, export-led (or dependent) growth regime produced an international imbalance causing an international pressure on China, in particular, the international demand for the pressure to devalue the yuan. Therefore, the switchover to a

5) Of course, the decline of the share of consumption should be due to the cuts of public services including medical services, housing, and education. Nevertheless, the lack of distribution of income to workers should be the major factor of this phenomenon in the sense that it was not enough to compensate the cuts of welfare facilities.

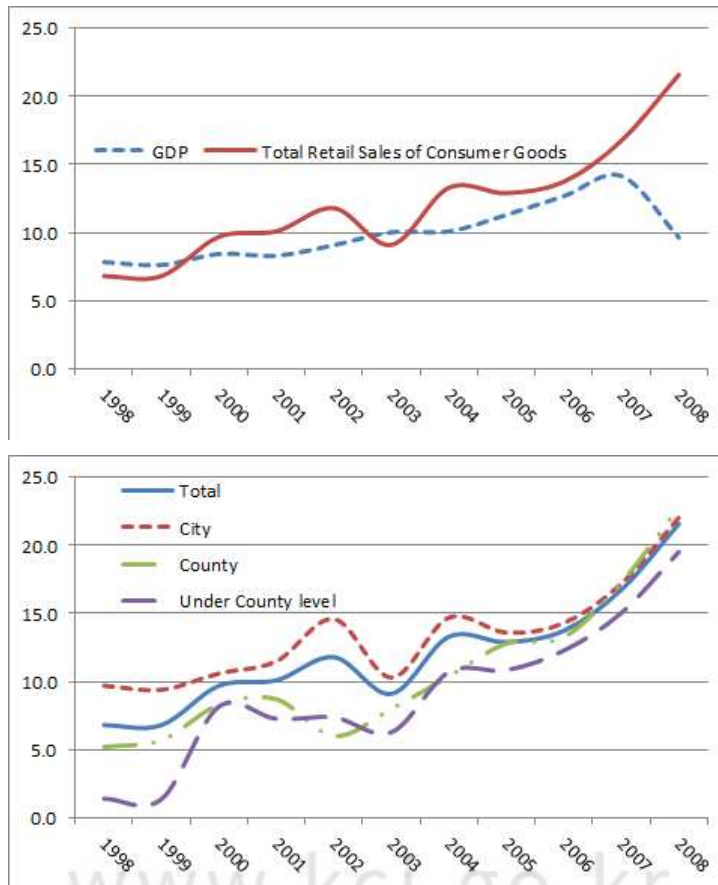
domestic consumption-led economic growth regime through improving domestic income could be a multi-purpose strategy that can solve problems of the social conflict within China and international imbalance at the same time. In this sense, it can be seen as an economic version of the goal of a harmonized society, which contains in effect the concrete package of policies for narrowing the gap between social classes, regions, and between cities and rural areas. The growth strategy through boosting domestic consumption is definitely apparent in the short-term policy of China suggested in response to the recent global economic crisis as well as the several mid- to long-term projects mentioned earlier. The policies to support domestic demand through narrowing various discriminations and gaps that have been consistently pursued since the Asian financial crisis can be said to be a strategy accelerated in a more extreme form under the recent global economic crisis. In fact, on November 9, 2008, the Chinese government announced a massive domestic boosting policy amounting up to a total of 4 trillion yuan for 2 years. The emphasis of this program is placed on investments in rural areas rather than cities, and especially the less developed western regions. A great weight was also placed on increasing the income of farmers and boosting their consumptions.

IV. Prospects on the Mid-Long Term Development of the Chinese Economy

It seems that China's strategy of switching over to a new development mode which started off since the Asian financial crisis and was accelerated in the middle of the recent global economic crisis, was not so successful up until the present. Paradoxically, the implementation of such system conversion strategy has mainly focused on capital-intensive investments, and consequently the share of the consumption in GDP has been accurately moving in the opposite direction to what was expected: domestic consumption has declined relative to investments, while investments increased (See Figure 6. Please note the fact that the share of domestic consumption since the Asian financial crisis when such transitional strategy was launched steadily and rapidly deteriorated). As a result, although the Chinese domestic consumption grew to some extent to 37.3% in 2008 after recording its lowest in history of 35.4% of the GDP in 2007, the share of China's domestic consumption is maintaining the lowest level in the world. Reflecting the decline of the relative importance of the Chinese consumption, Croll(2006) concludes that China has not entered into a mass consuming society yet. According to this study, China's consumers market is strictly

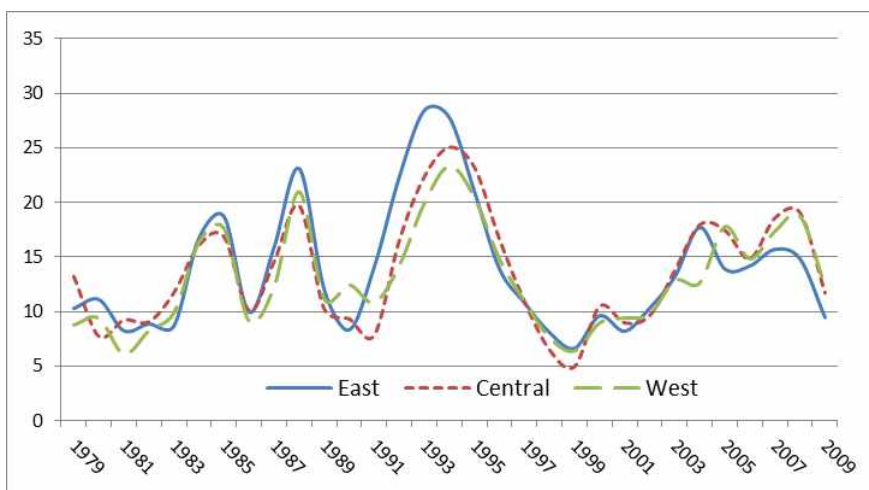
segregated between a very small wealthy consumer class and the public consumer class, and the latter takes most of the consumers. Furthermore, while the former market is growing rapidly, the growth of the latter lags far behind. Even merchandises for sale are divided into premium products for the former and low price-low quality products for the latter. Even market assessment organizations like Morgan Stanley and Meryl Lynch emphasize that the share that China takes in the global luxury brand market will expand in the future. This structure of consumer market implies that the engine spurring the growth of the Chinese economy still depends on government investments and the global market rather than domestic consumption demands. Ultimately, the strategy for switching over to a domestic consumption-led growth regime can be understood as a policy for easing social tension in China. When evaluating the result up to the present, these strategies are supported by government-led investments, not the final consumption of domestic households. Therefore, on one hand, it can be evaluated as not being successful in achieving its original goal.

Figure 7. The Rate of Growth of GDP and Retail Sales of Consumer Goods



On the other hand, the justification and possibility of realizing such a solution is being anticipated. The fact that can be pointed out first is that the recent increase of consumption is being maintained and even accelerated recently. Figure 7 shows the trends of retail sales of consumer goods and GDP growth. As it shows, the retail sales of consumer goods has maintained faster growth than GDP after 2000 with exceptional year 2003. In particular, it has grown explosively recently after 2005, defeating phenomenal growth rate of GDP, and the gap is widening gradually. When looking at it by region, the increasing trend of consumption in the Chinese cities is spreading to local levels. As the below panel of Figure 7 shows, up to the middle of 2000, consumption has been led by cities and that of county and under county level has relatively stagnated. However, this old trend turned its pattern recently in which growth of consumption of county level converges to that of cities at even higher rate of growth. The rising consumption trend of county and under county level is a very encouraging phenomenon because 54.9% of the Chinese population (based on 2008) is residing in rural areas and even now, China has a very large share of agriculture. In addition, since the early and mid-2000s, the number of employees and wages supporting the consumption demands are growing relatively fast. The amazing fact is that the growth rate of per capita income of inland areas is growing at a faster rate than eastern areas after 2000 (Figure 8). These facts seem to be the direct result of the balanced growth policy.

Figure 8. Regional Growth of GDP per Capital, 1979–2009 (%)



Source: Calculated by author from GTA Database 2011

The fact that the recent increasing trend of consumption and income is largely dependent on government policies suggests that the strategy to switch to a domestic consumption-led growth regime can be successful, if possible, in the mid and long term. In fact, the Chinese

government has been focusing on policies for expanding the domestic market such as improving the purchasing power of middle and low income classes through the 11th 5-year plan (2006~2010) and minimization of the income gap among regions. During 2006 and 2007, the provincial governments promoted the non-agricultural workers in rural areas to relocate to the city by reforming the household registration system while raising minimum wages by more than 10%. In 2004, by enacting 'minimum wage regulation', the Chinese government has also stipulated that the provincial governments should raise minimum wages more than once every 2 years. The worker's average wage rose rapidly with this high wage inducing policies. In the meantime, the policies for expanding the rural income through abolition of agricultural tax, raise of the purchase price of grains, and expansion of subsidies for farming tools and machines are constantly underway. In the third Plenum of the 17th Central Committee of the Communist Party of China (CPC), agricultural reform was adopted as a top priority task, and 716.1 billion yuan is to be invested for this reform from 2009. Moreover, policies for improving the real income of urban workers such as the enactment of the Labor Contract Act (Jan. 2008) for the stabilization of labor employment (limitation of short-term labor contract withdrawal, lifetime employment) and guarantee of labor union activities in addition to the raising of minimum wage, and the raising of minimum income tax base of workers (from 1,600 yuan to 2,000 yuan, Mar. 2009) are being constantly carried out. Furthermore, as a part of the recent economic stimulus package, massive policies for supporting real purchasing power were carried out temporarily.

According to traditional economics, this kind of government-led development may not be sustainable because it will worsen the government debt situation. In fact, right after the Asian Financial Crisis, government debt rose significantly due to the expansionary fiscal policy of the Chinese government in the way of coping with the crisis. The fiscal deficit which used to be only 1.18% of the GDP in 1998 greatly increased every year for 3 consecutive years from 1.94% in 1999 to 2.29% in 2000 and 2.26% in 2002, and increased the accumulated deficit. But, despite such increase in fiscal deficit, the share of government debt relative to GDP actually dropped. It was because the profitability of enterprises was improved due to this expansionary fiscal policy, which in turn led to the increase in the fiscal revenue as GDP grew faster. According to the official estimation of the Chinese government, the expansionary fiscal policy raised the growth rate of GDP every year by 1.5~2% points between 1998 and 2002. Due to the fast growth of the GDP and the consequent increase of fiscal revenue, the fact that, despite the rising absolute amount of government debt, the ratio of government debt to the GDP is maintained at a stable level implies that the expansionary fiscal policy has a positive effect even in the long run and can be a sustainable strategy. In addition, the largest part of the current government-led

economic stimulus package has turned to investments. This is combined with the balanced growth plan and most of it was concentrated on constructing the infrastructure of underdeveloped areas. But this fiscal policy focused on investments has not shown yet effects in increasing employment as much as it was anticipated, and it instead has been strengthening the economy's characteristic of capital-intensive growth. However, from a mid-long term perspective, the construction of such infrastructure could induce private investments which require the infrastructure. For instance, the reason that foreign direct investments recently increased in the inland areas is not irrelevant to the expansion of such infrastructure. This kind of result is consistent with the recent empirical findings that the natural rate of growth of OECD nations is not largely dependent on exogenous variables such as technological progress by inventions or discoveries, but on the current actual economic outputs (Jeon and Yoo 2009; León-Ledesma and Thirlwall 2002). In essence, an expansionary fiscal policy relying on infrastructure investments not only can boost the economy in the short-run, but also could expand the potential production capabilities to absorb employment by attracting private investments in the long-run. The rising income caused by this would likely to lead to the surge of consumption which in turn can become the foundation of switching to the domestic consumption-led growth regime.

There are also other probabilities in the future such as the increase of the share of high value-added service industry in the way of switching to a developed economic structure that can raise the Chinese domestic income. Generally, because the share of the service industry goes up as the economic development progresses, the revitalization of the service industry as a consumption market can be anticipated with its high potential in the mid- to long-run. In order to prepare for this kind of structural change, the Chinese government is planning to revitalize the service industry by allowing private enterprises to enter the basic infrastructure, insurance, culture, education, healthcare, and public service sector. However, the increase in domestic income due to such industrial advancement and the consequent increase in consumption do not happen automatically. For example, just as the developed economies' suffers from, industrial advancement can cause 'growth without employment' or polarization. Therefore, in order to create a virtuous cycle between economic growth and the improvement of living standards by evenly distributing the benefits of growth, the social security system such as health care, pension, and education must be expanded, and the safety net throughout the society that can guarantee job security and labor income must be secured. Although the domestic expansionary policy of China cannot be said to be complete nor is its effects outstanding, it is producing a somewhat positive anticipation in the sense that it is consistent with the direction of the government.

In recent times, pessimistic views on the future of China are being submitted from a

political perspective. While there are economic factors playing part in the basis of such pessimistic outlook, the tendency to stress political and social factors are more dominant than the former factor. The most important cause of this pessimistic view is the fact that there were no reforms in the political sector unlike the economic reform which has been underway since 1978. According to this viewpoint, Chinese political structure of a one communists party system might turn the country into a predatory state due to rising corruption of government officials which would erode the national capacity and widen the social and political gap, and this will eventually threaten the long-run growth of the economy by giving birth to the distortion of an economic order (Pei 2006). This view is implicitly dependent on the supposition that political democracy is an essential condition for the long-run economic development. However, this view is at least controversial rather than definite theory. First, the presupposition regarding the relationship between political democracy and economic growth is completely a western perspective and is a controversial issue still in dispute from a historical perspective. Second, according to historical experience, in most cases, the developmental state was weakened by the erosion of economic powers which grew under the protection of the developmental state rather than the corruption of internal officials. Even in the case of China, there are no clear explanations on this pessimistic view regarding problems like the extent of corruption among government officials, the content and size of economic distortion it will bring about and its results, and through which route this economic distortion will hinder the growth potential. It is just the 'political' view combining the notion of 'democracy = economic growth' and the market-centered view of 'free market = anti-corruption = economic growth.' Third, the experience that China has shown over the past 30 years is that they have grown rapidly 'despite' corruptions. Besides, the Chinese economy and society still lags behind developed countries but it is gradually growing transparent compared to the past and its corruption is also gradually diminishing. Fourth, unlike the views from the West, there is still relatively less demand for a Western democracy within China, especially, from industrial sectors (Tsai 2007). Rather, the current private industrial sector has grown adapting to the unique political structure of China, and therefore, it even shows a conservative tendency to support the current political system. That is to say, 'despite' the one party system, Chinese enterprises have grown rapidly while adapting to the system.

There are also serious criticisms on this pessimism. First, China is a developing country with per capita GDP of 4,000 dollars and is an economy which still has enough room to maintain additional economic growth through simply increasing investments. In fact, China's rapid growth since the 2000s was largely dependent on large scale investments, and the country is already carrying out a massive mid-long run investment and development plan

such as the Great Western Development Programme and Northeast Rehabilitation Plan. Second, the key to the specific path taken in switching to mid-long run growth lies in that China's large investments are concentrating on developing infrastructure. This can produce the effects of crowding-in private and foreign investments because it expands the growth potential through the expansion of productive capacity as well as improving the overall business condition. The trend of foreign direct investments which had been concentrating on the coastal areas moving to inland area in recent times should not be irrelevant to the opportunities provided by such investments on infrastructure. Third, these large scale investment projects carried out until now were government-led investments based on government spending. Therefore, in order to accomplish this, it must be backed by massive finance. But the current financial condition of Chinese government is assessed to be very good in global standards. Compared to the ratio of government debt to the GDP of each nation in 2008 including 71% of US, 196% of Japan, 67% of Germany, that of China was only about 35% even when adding up provincial government debts and additional economic stimulus measures in 2008-2009. Besides, as pointed out earlier, while the Chinese government has recorded an unprecedented fiscal deficit more than 2% of its GDP between 2000 and 2003 after the Asian Financial Crisis, the experience of having the national debt to GDP ratio drop due to the fast economic growth led by the fiscal stimuli implies that the government's investment on infrastructure may not significantly worsen its fiscal conditions. Fourth, the investments and expenditure led by the government includes restructuring activities like R&D for switching from the extensive growth system of the past to an intensive growth system. Such government efforts to switch to a technology-knowledge intensive economy can be expected to contribute to an important element in clearly expanding the future growth potential of China.

The development direction of China since the Asian Financial Crisis aims to convert from export-led growth to domestic consumption-led growth. Up to the present, government investments take the largest part of "domestic demands." However, even the Chinese government is fully aware of the fact that such government leadership is not the ultimate goal nor is it ideal. The problem is switching the initiative of the government investments into domestic consumption, and this requires the reform of the entire social system. In other words, in order to enhance domestic consumption instead of investment, income distribution must be improved, unemployment be reduced, and a system that can provide comprehensive social services should be established. Even if this 'massive switch' is successful, it is a social policy that will require a lot of time. In short, China still has no choice but to depend on exports and investments for a while, and this possibility is still very high in present times. However, the task of completing a sustainable growth system in the long-run by

increasing demands for personal consumptions depends on how well China can achieve the massive change in income distribution, unemployment, and the social security system.

V. Conclusion

China is facing double challenges of having to not only solve social conflict by narrowing gaps in various forms internally but also having to minimize global imbalance to the outside. The Chinese solution is to transform itself to a domestic demand-led economic growth regime. With this, they can alleviate foreign imbalance and solve its internal conflicts at the same time. To achieve this, China has been carrying out massive government invested projects since the Asian Financial Crisis. It is too early to say it has been generally successful. Although the income of inland areas is on the rise, it is still very insignificant, and the trade surplus is rather rising. Behind such insignificant results lies the fact that the main agents of 'the domestic demand' are not the public but the government and a small number of upper class. Nevertheless, the prospect of this strategy can be evaluated as being positive. The massive construction of the infrastructure led by the government expenditure has a high possibility of displaying a comprehensive (or inclusive) and extensive effect in the not too distant future.

Therefore, the current challenge the Chinese government faces is about how the massive investment project led by the government can improve the purchasing power of the Chinese people. Investment is a very necessary process in the sense that it can improve productivity through technological advancement and increase in the dynamic returns to scale. Furthermore, to boost the domestic economy under the situation where there is insufficient final consumption, government intervention is inevitable, and investments may be a process that must be gone through just to upgrade the Chinese industry and secure the competitive edge in the global market. However, without sufficient creation of jobs and increase of income, this kind of government investment-led growth system is not sustainable in the long run nor is it bearable socially. Hence, the future strategy along with macroeconomic demand management policies and all the policy sectors such as income redistribution policy, reforms of social security system, labor market regulations, and international trade policies must be organized consistently and systematically under a more inclusive social goal of promoting the welfare of the Chinese people. In the same vein, Stiglitz(2008) also pints that the 11th 5-Year Plan (2006~2010) can be evaluated as a policy package for heading towards a unique New Economic Model, which should be distinguished from the previous Anglo-Saxon model that has been followed by Western economies and sometimes forced on under developed

countries sending up with bigger problems. As pointed out earlier, the reason is that the growth system led by public demands would be of great help in not only improving the welfare of the Chinese people but also easing the global imbalance associated with China.

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Abstract

Political Economy of the Beijing Consensus: Its Past, Present, and Future

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The overall figures or a eco-political system of China that outstanding achievements have relied on is carefully coined 'Beijing Consensus' by political economists. The neology has been used to indicate the uniqueness of the Chinese eco-political system and to analyze the responses of the third world against the policy suggestions for development enforced by the Western developed economies and world economic institutions. However, the initiative concept has not been formalized nor has its reality been fully analysed yet. The present paper aims to fill this gap. By reviewing the Chinese development process, this study is to contextualize in a historical perspective the development process and its urgent challenges that the Chinese socio-political system faces. It shows that the radical reform process after the mid-1990s created both internal and external imbalances. Encountering these challenges, the Chinese leadership has taken since early 2000s a strategy to switching over to domestic consumption-led growth regime. However, this paper argues that this requires the reform of the entire social system including social security net and income distribution system as well as economic regime.

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