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Fundamentals of China's Miracle

Before we unveil the dynamics of the China's miracle, I would like to quote the famous poem of great thinker and philosopher Allama Muhammad Iqbal in his book Zarbi-Kaleem with a "Fannon-i- Lateefa (Fine Arts)"¹:

اے اہل نظر ذوقِ نظر خوب سے لیکن
جشنے کی حقیقت کو نہ دیکھے وہ نظر کیا

O people with observing eyes, a
taste for observation is a good things,
But what good is observation if it does not see
the inwardness of things?

مقصودِ مہنہ سوزِ حیاتِ ابدی ہے
یہ ایک نفس یا دو نفسِ مثلِ شہر کیا

The aim of art should be to generate a vital flame that never dies.
What use is a mere momentary spark?

جس سے دلِ دریا مُستِ لاطم نہ بیچتا
اے قلمِ فریساں وہ صدف کیا وہ لہر کیا

1 "(Zarb-e-Kaleem-128) Funoon-e-Latifa", Iqbal Poetry, available at
<https://iqbalurdu.blogspot.com/2011/04/zarb-e-kaleem-128-funoon-e-latifa.html>

What good, O rain-drop, if you do not agitate the bosom of the sea,
And are content to be a pearl lodged in a mother-of-pearl's womb?

شاعر کی نوا ہو کہ مُغنی کا نفس ہو
جس سے چمن افسردہ ہو وہ باجڑ کر لیا

What good a breath of morning breeze,
Whether as poet's verse or singer's air,
If it can only make the garden wilt?

بے عجز نہ دنیا میں اُجھرتی نہیں قومیں
جو ضربِ کلیدی نہیں لکھت وہ ہنر کیا!

O never without miracles do people rise;
What good is art that does not have
the impact of the rod of Moses?

In last part of the poem, Iqbal has rightly alluded that nations can rise only through doing miracles and for that you have to acquire the requisite strengths. The rise of modern China is not less than a miracle. The China miracle is manifested in the extraordinary performance and decisions of China in the post reforms and opening up era, after the comrade Deng Xiaoping approach. The first generation of Chinese leadership was highly focused on cementing the foundation of Chinese society on the principles of Marxist Socialism and to create public goods, through unity, sacrifices and delivery of services. After Globalization and development of open market economy, the second generation leadership of China, fostered the opening up reforms to improve the socioeconomic conditions of China, by making it an active partner in the global economy, but still

adhering to the basic identity of the Socialist nation. In this chapter we will try to answer three fundamental questions. What is the nature of China's miracle? What are the determinants and dynamics of this miracle and thirdly whether this miracle is sustainable or not?

The reforms and opening up policies of China can be divided in the following stages:

- i. Reform of Rural Areas
- ii. Reform of State-own Enterprises- five stages
 - a. 1st Period: The Initial Stage (1978-1984)
 - b. 2nd Period: Contract Stage (1985-1990)
 - c. 3rd period: Transformation (1991-1993)
 - d. 4th Period: Modern Enterprise System (1994-2002)
 - e. 5th Period: Shareholding system and Diversified Ownership Economy(2002-now)

The China's reforms are strikingly different from the rest of the world in many ways. China started from a very poor economy and downtrodden society after its independence. The nation was mostly based on agriculture economy with very low per capita production and inefficient systems. The poverty in the country was exuberant and common person was living in a very deplorable conditions. The initial years of the country were dominated by centralized ration system for food items and food coupons were issued to individuals to make their both ends meet. These food coupons were distributed amongst the households for certain limited quantities of food rations. One food coupon is shown in Fig 4.1. People have to stand in long queues for collecting ration.



“Food Coupons Issued by the People's Republic of China” available at <http://www.paulnoll.com/China/Money/money-PRC-01R.html>



“Food for 30 years of reform and opening up: No need to queue up to buy food”, China Central Television, available at <http://news.cctv.com/china/20080927/105799.shtml>

In the presence of a strong one party based Government, the politics in China remained forcefully peaceful as there was no opposition to the party politics and governance. This provided a unified concentration to the leaders for improvement of the socioeconomic conditions of the country. In contrary the other transition country of the region, were marred with political instability, poor consensus on the national priority agenda and lack of collective wisdom on the national and international issues.

The historical speech of Deng Xiaoping on “Truth from the Facts” at the end of 1978 turned the tables for reforms in China. In the subsequent Third Plenary Session of the 11th Central Committee of Communist Party of China (CCCPCP), which laid

out a tentative program of reform to move away from the planned economy². During the earlier cultural revolutions, leaders like Deng Xiaoping and Hua Guofeng, greatly suffered for their ideas of the agricultural reforms, which were banished by the first generation leaders of Mao era. Nevertheless, the second generation leaders still adhered to smooth transition and opening to avoid any pitfalls and crisis, while keeping with the identity of a Socialist nation. The reforms started from rural areas with the household responsibility system and township and village enterprises, and some initial steps to open up the economy to foreign trade and investment, which only started to play a significant role in the 1990s³. Initially the reforms were not visible and dominant, however in the mid-1990s, these got momentum. The overall broader reforms strategy emerged in 1993 with the “Decisions of establishment of Socialistic Market” but these reforms were implemented gradually on experimental basis⁴. The major reforms are illustrated as follows:

- 1978: Communiqué of the third Central Committee of the Chinese Communist Party (CCCPC) plenum of the 11th party congress initiating “four modernizations”
- 1979: “Open door” policy initiated, foreign trade and investment reforms begin. Law on Joint Venture Companies passed
- 1979 Limited official encouragement of household responsibility system 1979 Three specialized banks separated from the People's Bank (the central bank). 1980 First four special economic zones created
- 1980: “Eating from Separate Kitchens” reforms in intergovernmental fiscal relations 1984 Individual enterprises with less than eight employees officially allowed

2 In Deng Xiaoping's meeting with Robert McNamara in April 1980, Deng indicated that China would open up, reform, and modernize—and that it was likely to succeed with or without the Bank, but that the success would be smoother and faster with Bank support.

3 Bert Hofman Jinglian Wu (2009)-Explaining China's Development and Reforms-Commission on Growth and Development. The International Bank for Reconstruction and Development

4 The Communiqué of the third Central Committee of the Communist Party of China plenum of the 14th party congress.

- 1984: Tax for Profit reforms of SOEs
- 1986: Provisional bankruptcy law passed for SOEs
- 1987: Contract responsibility system introduced in SOEs
- 1989: Tiananmen square events trigger retrenchment policy, halt on reforms
- 1990: Stock exchange started in Shenzhen, Shanghai
- 1992: Deng Xiaoping's "Tour through the South" reignites reforms
- 1993: Decision of the third plenum of the CCCPC of the 14th party congress to establish a "socialist market economy" paved way for fiscal, financial, SOE reforms
- 1994: RMB convertible for current account transactions 1994 Tax-sharing system reforms introduced
- 1994: Policy banks established, commercialization of banking system announced
- 1995: Central Bank Law, Banking Law, Budget Law enacted
- 1997: Comprehensive plan to restructure SOEs adopted, "grab the big, let go of the small"
- 2001: China's accession to WTO
- 2003: 3rd CCCPC plenum of the 16th party congress, decision to "perfect" the socialist market economy
- 2004: Constitution amended to guarantee private property rights
- 2005: Construction Bank, Bank of China initial public offerings
- 2006: 6th CCCPC plenum of the 16th party congress establishes the goal of "Harmonious Society"

Source: Hofman *et al.* 2007⁵.

The China's approach of gradual transition was owed to many reasons. Firstly, to mend the resistance from the CPC as after the first generation, many political leaders were looking at the reforms agenda through suspicion. Secondly, gradual transition in the political and economic systems is always a proactive and

5 Hoffmann B and Jinglian W (2009) 'Explaining China's Development and Reforms' working paper is a product of the Commission on Growth and Development-Sponsored by Australian Agency for International Development (AusAID) and others.

sustainable approach as it provides ample adjustment time for the people and society. In this process, even the adversary to the transition can understand the dynamics. Thirdly the experiment based reforms were well suited to the culturally strong Chinese society, where an experiment could be easily abandoned at small scale, in case of failure. The pilot approach in the policy making and its implementation always suits in the transition states.

The first and most important attribute of the reforms was its decentralization and experimentation. In first phase, local Governments were given increased authority in the matters of investment approvals, fiscal resources, and policies. The fiscal reforms were introduced in 1980 under famous phrase "*Eating from separate Kitchen*". Under this rural reforms system, the local governments were empowered to retain greater part of their revenue with minimum tax on flat rate. At the party level, the promotion was linked with the personal growth and achievement of the priority agenda. This first phase of reforms created macroeconomic controls issues with special reference to high inflation rate. This became major agenda of the subsequent reforms. The system was soon replaced with mainstream tax sharing system to curtail inflation and ensure macroeconomics stability. The concept of pragmatic transitional institutes was adopted in the next level of reforms. For example, the Township and Village Enterprises (TVE), born out of the Collective Production Brigades (CPB) was very successful in improvement of productivity and creating employment. This model proved relatively more feasible than the State Owned Enterprise model. With the improvement of private property rights protections, TVEs were converted into private companies with investment from inside and outside the country.

The major reform areas included agricultural sector, trade and investment policies, Financial sector reforms, State Enterprise Reforms and Macroeconomic Policy. China pursued liberalization of the price system, opening up for trade and foreign investment, commercialization of the financial sector, privatization of the economy—all while maintaining a reasonable level of

macroeconomic stability. With reforms in agriculture sector by 1982, almost 90% of the lands were leased and contracted for different tenures from 3-5 years, which resulted into increase in production and cultivation of new crops. The increased use of fertilizers, enhanced mechanization, diversified food basket and change in incentive system led to growth of rural economy. This created green revolution in China and the dividends of the agricultural reforms reached the common masses.

The reforms in trade and investment policies in last 4 decades remained very dominant and China has become one of the favorite countries for Foreign Direct Investment (FDI). These reforms were pursued in three steps: i). gradual liberalization of the trade planning system; (ii) gradual reforms in the exchange and payments system; and (iii) opening up to FDI. The Foreign Trade Companies, which earlier monopolized the foreign trade lost its existence and the establishment of Special Economic Zones (SEZs) attracted large amounts of FDI. Rationalization of Taxes and tax incentives, boosted the trade and investments in China. This was coupled with the rationalization of exchange rate. Earlier the foreign trade was possible through the Central Bank of China only but after the reforms, the foreign banks were also allowed to setup their branches in the SEZs. By 1986, all domestic banks were allowed for the foreign trade transactions.

The Financial Sector reforms of China also continued at gradual pace which included steady increase in the type and number of banks combined with a gradual relaxation, and then abolition, of most restrictions on lending by those banks. Four specialized banks were established as i). The Agricultural Bank of China specializing in rural finance; (ii) the People's Construction Bank of China, specializing in investment financing; (iii) the Bank of China, specializing in international financial transactions; and (iv) the Industrial and Commercial Bank of China, focusing on working capital financing.

For State Enterprise reforms, China gave more rights to the enterprises. Under the Enterprise Contracting System (ECS)

adopted in 1983, the residual profit was transferred to the enterprise which created inflation and subsequently Tax for profit concept was imposed. The managerial rights of the enterprises were further enhanced in 1993 and the Company Law, laid the foundation for corporatization of 100 State Owner Enterprises (SOEs). In 1999, the program for diversified shareholders was introduced, however the success of these initiatives is yet to be seen, as the interference of the Government in the executive level decisions and appointments are still continuing. For macroeconomic stability, the Central Bank role for centralized control over monetary policy was defined in the reforms decisions of 1993. For noninflationary means of financing the deficit, government bonds were created. The interest rate was gradually liberalized and linked with interbank rate in mid 1990s⁶.

The success of China's reforms is also linked to their sustainability over long time. The indigenous design of the reforms, well suited to the domestic conditions made it more successful in implementation.

i. *Achieving Great Economic Success*: China witnessed one of the highest growth rate in its history after the reforms. The annual GDP of China increased by 20-30 times, as compared to base year of 1978. The Global Innovation Index rating of China has increased 43rd to 22nd during 2009-2017. The economic status of the countries has raised from low income country in 1978 to upper middle level countries in 2017. The average GDP growth rate of China during 2000-2014, has been 10%, whereas for US, it was 1.8%. This growth rate was even better than the four Asian Tigers (Taiwan, Singapore, Japan and South Korea). The GDP growth rate of China during 1978-2017 is given in following Table⁷. As strongest Socialist country of the world, China with high investment in innovation and advanced technology. In 2017, China ranked second in terms of publishing scientific papers and ranked first in the patent applications filed.

6 Zhili Bai & Juan Liu (2020) China's governance model and system in transition, *Journal of Contemporary East Asia Studies*, 9:1, 65-82

7 World Bank, 2019. *World Bank National Accounts Data: China 1960-2017*.

The agricultural sector of China contributed significantly to the national growth. Today China produces 18% of the world's cereal grains, 29% of the world's meat and 50% of the world's vegetables⁸. The efficiency of the Chinese agricultural system can be imagined from the fact, that from 9% of the total global cultivated areas, China produces 20% of the global food. China remained the major exporter to Europe, US and Asia. The value addition of manufacturing sector of China was about 35.1% and the gross value added manufacturing stood at 28.9% of the GDP during 2013, as against 12.1% in the United States and 18.7% in Japan. After becoming member of the World Trade Organization (WTO), China rationalized the tariff and non-tariff barriers to international trade. The value of China's merchandise exports increased from \$14 billion in 1979 to \$23 trillion in 2014 with an annual growth of 18.0% from 1990 to 2014, whilst importation of merchandise rose from \$18 billion to about \$2.0 trillion with an annual growth of 16.6% in the same period.

8 United Nations, UNdata, available at <http://data.un.org>

Volume and growth rate of China's GDP during 1978-2017

Year	GDP (current US\$ billion)	Growth rate (annual %)
1978	149.541	11.667
1979	178.281	7.6
1980	191.149	7.807
1981	195.866	5.172
1982	205.090	8.934
1983	230.687	10.835
1984	259.947	15.139
1985	309.488	13.443
1986	300.758	8.94
1987	272.973	11.689
1988	312.354	11.235
1989	347.768	4.186
1990	360.858	3.907
1991	383.373	9.294
1992	426.916	14.216
1993	444.731	13.868
1994	564.325	13.052
1995	734.548	10.949
1996	863.747	9.928
1997	961.604	9.231
1998	1,029	7.838
1999	1,094	7.667
2000	1,211	8.492
2001	1,339	8.34
2002	1,471	9.131
2003	1,660	10.036
2004	1,955	10.111
2005	2,286	11.396
2006	2,752	12.719
2007	3,552	14.231
2008	4,598	9.654
2009	5,110	9.4
2010	6,101	10.636
2011	7,573	9.536
2012	8,561	7.856
2013	9,607	7.758
2014	10,482	7.298
2015	11,065	6.9
2016	11,191	6.7
2017	12,238	6.9

Source: World Bank, 2019. World Bank National Accounts Data:

China 1960-2017.

The China economic miracle can be attributed to many factors but some of the very dominant factors include⁹:

- i. Quality of leadership (Credible, Competent and Committed 3C's Leadership)
- ii. Urge for sacrifice and commitment in common people to fight poverty and improve their society.
- iii. Learning from their mistakes and not repeating the same.
- iv. Gradual implementation of reforms on experimental basis along the learning curve.
- v. Empowerment of women and mainstreaming them in the national development
- vi. Unyielding commitment and resilience in the people. They have failed the failure and work only for success and creativity.
- vii. Peaceful co-existence and their staunch belief in the peace and mutual respect to create win-win situations for all. Contrarily, US has spent about USD 7 trillion on useless wars in the world.
- viii. Humility and submissiveness in the nature of Chinese, have made them more respectful society with no arrogance and egoism at individual and national levels.

China, has to address the challenges related to Climate Changes, New Technologies, Belt and Road Initiatives (BRI), uncertainties around the global trade & investment and domestic economic structural changes. The China growth story for medium to long term must be sustainable, inclusive, low carbon based and market oriented¹⁰.

China's new form of development must focus on all the four types of capitals, i.e.

9 Excerpts from the Speech of Senator Mashahid Hussain at Conference on the 70 year celebrations of Pak China Diplomatic relations, held at Islamabad in July 2021

10 Hepburn C, Stern N, Xie C, Zenghelis D (2020) Strong, sustainable and inclusive growth in a new era for China - Paper 1: Challenges and ways forward. London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science

wellbeing and wealth: human, social, physical and natural capital. In past, the growth in China has been mainly focused on exploitation of the physical capital. However, in recent year, the importance of other types of capitals have been realized by the planners, as exploitation of these three types of capital will lead to pollutions, degraded physical resources, depletion of forest etc., which in turn will also lead to poor health of human capital. The combined decline of natural and human capital then, undermines the social capital. Thus sustainability must be the main agenda for the future development and growth model of China.

The modern technologies is leading the world to Fourth Industrial Revolution (I 4.0). This involves use of Artificial Intelligence (AI), Drone technologies, Cloud Computing, 3D printing, Virtual Reality (VR). Such distortion will create major challenge for the mainstreaming of all segments of society. Hence the major challenge would remain to involve and include the underprivileged and disadvantaged thorough reducing inequalities and promoting social cohesion in the process.

China being a major manufacturer in the global commodity market, has to understand the impact of Climate Change due to global warming owing to Green House Gases (GHG) emissions. The future manufacturing will have high emphasis over Clean and Green Technologies. The investment in renewable and clean energy must be the major impetus of the China future manufacturing policies.

Lastly for sustainable growth, the market oriented reforms have to be strengthened. The innovation and investment is mainly driven by the private sector, therefore market oriented reforms will be required to encourage creativity, innovation and competition.