

# Chinese Economy

Graduate School of Economics,  
University of Tokyo  
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Tomoo Marukawa

# **PLANNED ECONOMY IN CHINA**

# Planned Economy in China

- Theoretical Justification for abolishing capitalism and establishing planned economy
- Actual Motive
- Its Function
- Chinese Characteristics

# Theoretical Justification

- Bukharin and Preobrazhensky, *The ABC of Communism* (1920) points out that planned economy has two advantages over capitalism. First, the absence of the anarchy of production, and secondly the absence of class conflict. (cited from Michael Ellman, *Socialist Planning*)
- What “anarchy of production” means is: while capitalists pursue profits individually and accumulate production capacity, the working class is impoverished by exploitation, ending up into overproduction and crisis. The struggle for market between capitalists and nations ends up into world war.
- In socialism, human energy that has been poured into class conflict in capitalist societies will be liberated.

# Planning as a way of catching up

- Socialist revolutions were made in the era of imperialism. Most socialist countries (with the exception of East Germany and Czech) were backward countries, which might suffer from colonization if they stayed poor.
- Stalin explained the reason for launching the rapid industrialization program—the First Five Year Plan—in 1931 that if Russia stayed poor and weak, it would be beaten and enslaved.
- Since then, socialist planning has been adopted as a way of achieving rapid capital accumulation in the state sector at the expense of the people's living standard. As it entails the suppression of living standards, it can only be introduced under political dictatorship.

# Basic characteristics of planned economy

- State ownership of the means of production  
--supplemented by collective ownership
- Political dictatorship
- A mono-hierarchical system
- Imperative planning
- Physical planning

# Physical Planning

- Planning takes place in physical terms—that is to say, the goal is expressed in tons and cubic meters rather than dollars, and firms receive the allocation of materials in terms of tons, units, and cubic meters rather than dollars.
- The making of a plan is to balance aggregate supply (production) and aggregate demand (distribution) for all basic products, labor, and money in physical terms.  $\sum S_i = \sum D_i$

# The debate on the feasibility of socialism

- Mises (1920) argues that it is impossible to allocate producer goods efficiently and select the optimal technology without using prices. He says that it is impossible to make “economic calculations” in socialism.
- Hayek (1935) argues that it is impossible to create a composite demand function when people have different preferences. He also argues that it is beyond the capability of the central planner to gather all necessary information and calculate the amount of production and price for each good. Planners need to solve hundreds of thousands of equations.



# The debate on the feasibility of socialism

- Lange (1936-37) rebuts that general equilibrium prices can be obtained by a trial-and-error process. He says that if capitalism can reach Walrasian equilibrium through competition, so can socialism do. Workers receive remunerations according to their labor and dividends from publicly-owned capital and natural resources. Amount of production of a certain good is determined at a point where marginal cost equals the good's price.
- In short, Lange insists that planned economy can and should be run according to micro economics!

# The debate on the feasibility of socialism

- Dobb (1933, 1940) says that in socialism the selection of technology and goods to be produced can be free from price mechanism.
- Lange (1967) argues that with the development of computers the trial-and-error process are no more necessary. The equilibrium prices can be directly calculated.
- Will the latest information and communication technologies (ICT) enable planned economy?
- But what is the purpose of creating planned economy, anyway, if the “anarchy of production” can be overcome by ICT?

# Actual motive of creating a planned economy in China

- When the Communist Party came into power and established the People's Republic in 1949, its initial goal was “New Democracy.”
- In fact, the political regime was already Party and Mao's dictatorship. What “New democracy” implied was making full use of capitalism and capitalists while building the state sector.
- The most revolutionary act in the early years was land reform. Agricultural lands were redistributed from landlords to peasants—sometimes involving the assassination of landlords.

# The Turn to Socialism

- In 1953, Mao declared that China was in the transition to socialism. The first five year plan started.
- It was the period of Korean War (1950-53) and Cold War. China had to rely on USSR for the introduction of industrial technology. To build up a full-set modern heavy industry rapidly, the five year plan and Soviet-style economic system were introduced.

# The Korean War: Kim Il-song and Peng Dehuai



# The Socialist system

- State-owned or collectively-owned enterprises in industry.
- Rural collectives which engage in collective farming. The “people’s commune.”
- State Planning Commission and industry-wise ministries, like the 1<sup>st</sup> machinery industry ministry..7<sup>th</sup> machinery industry ministry.

# The socialist system

- From 1953, farmers were forbidden to sell grains to merchants. The state controlled from the procurement to the final sales of grain.
- Urban people were offered grain tickets, so they could consume up to the total amount of the rationed tickets.
- Enterprises received orders from the ministries regarding their production volume, production value, and employment.



# The function of planned economy

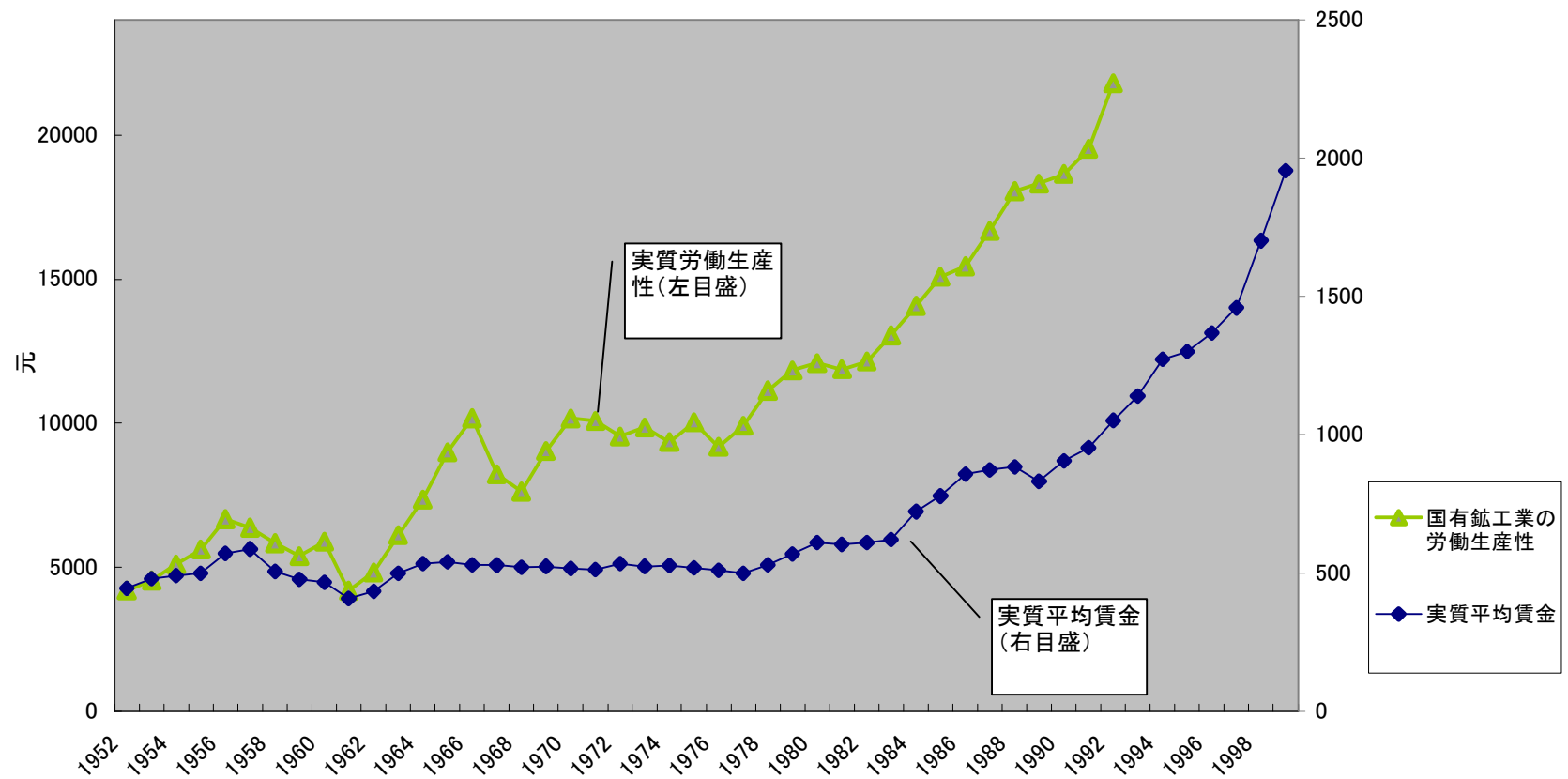
- The state ordered the amount of agricultural and industrial production and allocated the produce to the enterprises and people.
- Enterprises did not take responsibility for their profits and losses.
- Therefore, prices lost their function of resource allocation.
- Then what was the meaning of price?
- Prices were used to control income distribution. Grain prices were kept very low, in order to suppress the income of farmers and workers. Industrial products prices were high, so that the state-owned enterprises could earn a lot of profits. The profits were controlled by the state.



The relative price of agricultural products compared to industrial products was 48% lower than other countries.

While real labor productivity (green) increased, real wage (blue) did not increase at all until late 1970s.

図2-2 都市部の実質平均賃金と国有鉱工業企業の労働生産性の推移



(注) 平均賃金は小売物価指数でデフレートして実質化した。国有工業企業の労働生産性は1980年価格で実質化されている。  
(出所) 国家統計局綜合司編『全国各省、自治区、直轄市歴史統計資料匯編(1949-1989)』中国統計出版社、1990年 pp.32,34、国家統計局編『中国統計年鑑1993』p.431より計算。

# State budget under planned economy

## State income accounted for 27% of GDP

China's state budget in 1975			
Income		Expenditure	
		(100 Million Yuan)	
Total	815.6	Total	820.9
Enterprise income	400.2	Basic construction	327.0
Industry	329.0	circulating capital for firms	41.8
Agriculture, fishery	-8.5	New product development	24.6
Transportation	45.3	Geologic research	14.2
Commerce, bank	22.4	Industry, transportation	12.8
Others	11.9	Small firms' subsidy	6.9
Tax income	402.8	Agricultural subsidy	42.5
Industrial and Comm	348.0	Urban maintenance	10.4
Salt	10.3	Education, public health	81.3
Custom duty	15.0	Social relief	12.9
Agriculture, fishery	29.5	Subsidies for people moving to rural areas	10.2
Other income	12.6	National defence	132.1
		Administrative expenses	38.8
		Foreign aid	40.9
		Strategic storage	7.0
		Others	17.5

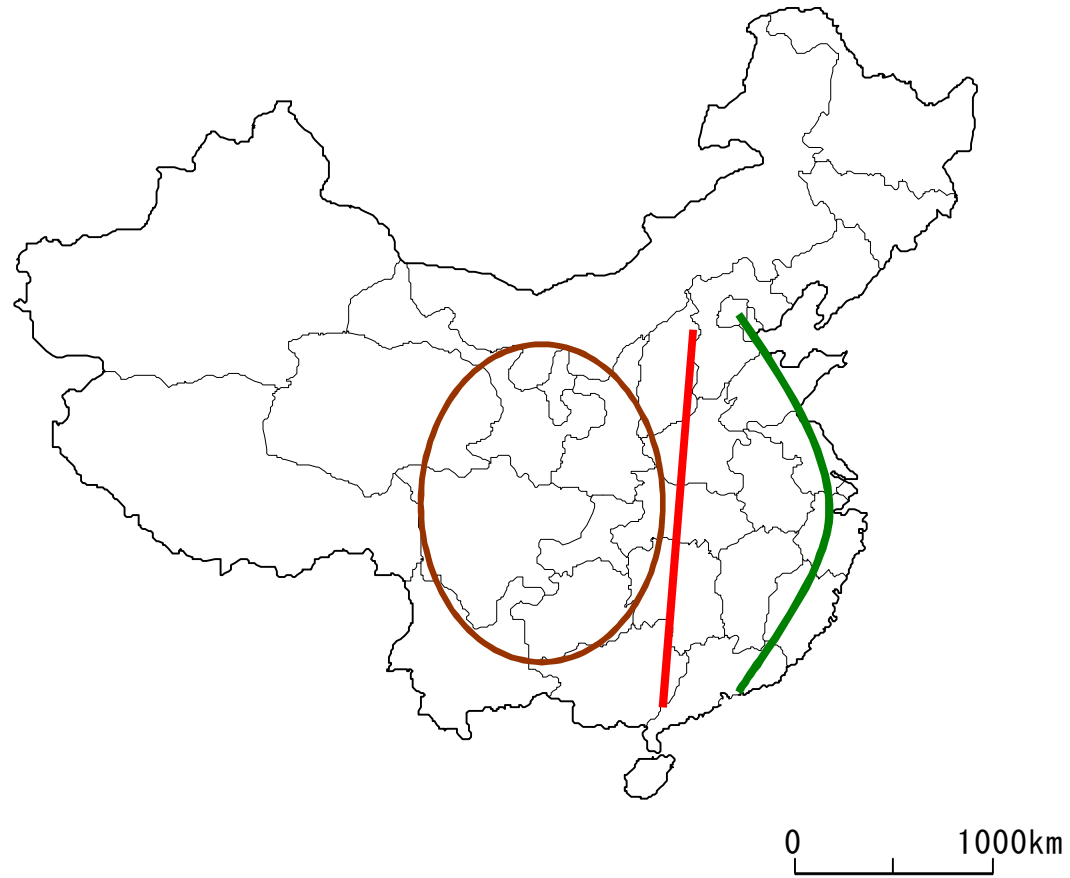
# China's planned economy started to deflect from the Soviet model

- In 1958, the Chinese suddenly stopped listening to Soviet advisors. In August, Chinese leaders suddenly decided to double the production of steel.
- A sudden disruption of the plan triggered over-reporting by local officials, various “innovations” which turned out to be of no use, sharp decline of agricultural production due to the reallocation of labor to industry, and starvation!
- USSR called back its advisors, and Chinese leaders put the blame of its difficulties on the Soviets.

# Militarization of the economy

- China had to face US threat without the support by the USSR.
- In 1969, China and USSR had a fight at the border.
- China developed nuclear weapons on its own and launched the “Construction of the Third Front” in 1964.
- 16% of state expenditure, or 4.4% of GDP was spent on national defense in 1975.

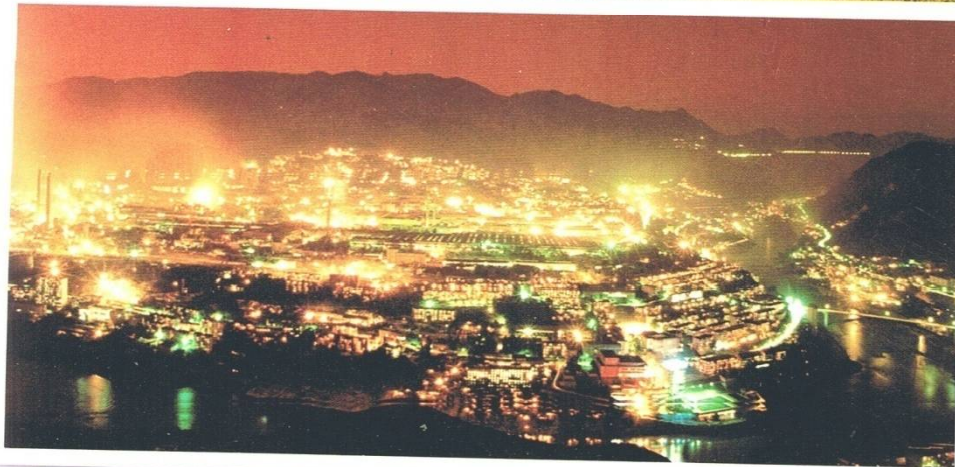
# The Third Front



# The biggest project in the third front— Panzhihua Iron and Steel Works



7 弄弄坪建设前的  
原始地貌

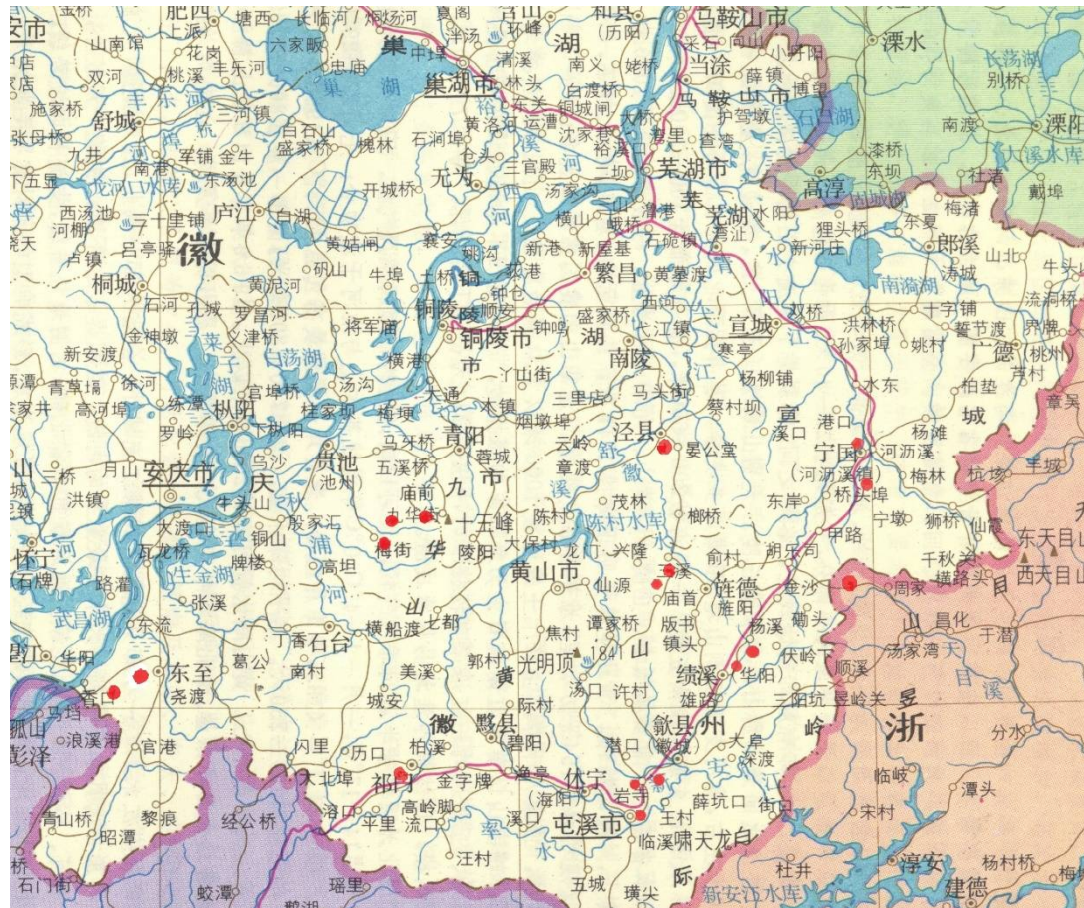


8 攀钢之夜

# The “Small Third Front” erected by Shanghai in southern Anhui Province

Anti-aircraft gun parts and steel castings

Explosives



Rocket ranchers, hand grenades, cement

Artillery shells, radars, searchlights, indicators

# Planned economy with Chinese characteristics

- Decentralization. In 1958, almost all state-owned enterprises were relegated from the center to local governments. In 1961, partial re-centralization. In 1970, re-decentralization.
- Mao wanted to motivate the local governments.
- He also envisioned a long war with the imperialists. He even imagined that China would be shattered into many small pieces. So he insisted that all provinces and even counties should have steel mills, power plants, and munition factories.





# Industrial structures quite different from the USSR

- Many competing firms were established in each industry.
- Every province had a full-set industrial structure.

Two-wheel tractor	96%	Cotton shirts, trousers	68%
Tractor	96%	Cotton cloth	67%
Agricultural engines	95%	Enamel washbowl	65%
Soap	93%	Rubber shoes	61%
Liquer	91%	Shirts	55%
Chemical pesticides	91%	Polyester cloth	51%
Chemical fertilizers	84%	Wool yarn	48%
Cotton yarn	79%	Silk cloth	48%
Powder detergent	78%	Sewing machine	42%
Galvanized iron wire	75%	Mixed-fiber cloth	37%
Man-made fiber cloth	72%	Bicycle	30%
Enamel cup	72%	Watch	20%
Sanitary shirts, trousers	68%	Transistor radio	19%

# The State Planning Committee control was limited

- In 1975, the SPC allocated 33 items of producer goods, such as coal, coke, steel products, rubber, cement, and 124 items of consumer goods, such as grain, vegetable oil, pork, rubber shoes, electric meter, TV set, ball point pen.
- Other products were traded directly between firms, or allocated by local governments.
- Grains and meat were allocated to the citizens but people bought vegetables, chicken, and eggs at the free market.
- The planned economy had to be complemented by extra-plan economy.

白菜(napa cabbage) was allocated in autumn for storage



# Napa cabbage @ market economy



# Questions

- Has planned economy even been conducted in some important realms in capitalist countries?
- Mr Marukawa, why did you want to go to China in the 1950s?
- How did the government balance demand and supply when there were overreporting?