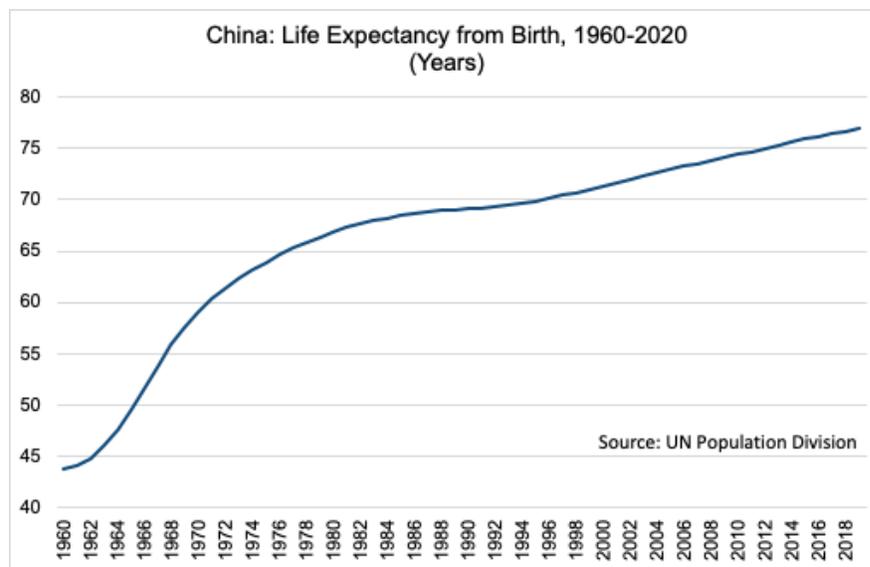


# **The Origins of China's Economic Growth: Reforms and Liberalization from the 1980's onward**

By Dante McClure

China has experienced unprecedented economic growth in the second half of the 20th century. China is currently the second largest economy in the world (with a gross domestic product (gdp) of 16.64 trillion<sup>1</sup>), and has maintained an average annual gdp growth rate of 10% for the last 30 years. By contrast, the United States of America - the current largest economy - has maintained an average gdp growth rate of only 3%, less than half that of China.<sup>2</sup> Even more encouraging have been the welfare effects of China's reforms. From 1980 to 2015, rural poverty in China has been reduced by 94%<sup>3</sup>. As Figure 1 illustrates, a Chinese person born in 2015 can expect to live nearly twenty years older than those born in 1970.



<sup>1</sup> "Report for Selected Countries and Subjects." *IMF*, <https://www.imf.org/en/Publications/WEO/weo-database/2021/April/weo-report?c=924%2C&s=NGDPD%2CPPPGDP%2CNGDPDPC%2CPPPPC%2CPPPSH%2C&sy=2015&ey=2026&ssm=0&scsm=1&ssc=0&ssd=1&ssc=0&sic=0&sort=country&ds=.&br=1>.

<sup>2</sup> "U.S. GDP Growth Rate 1961-2022." *MacroTrends*, <https://www.macrotrends.net/countries/USA/united-states/gdp-growth-rate>.

<sup>3</sup> "Ending Poverty in China: What Explains Great Poverty Reduction and a Simultaneous Increase in Inequality in Rural Areas?" *World Bank Blogs*, [https://blogs.worldbank.org/eastasiapacific/ending-poverty-in-china-what-explains-great-poverty-reduction-and-a-simultaneous-increase-in-inequality-in-rural-areas#:~:text=Since%201980%2C%20the%20country%20has,rural%20China%20\(figure%201\)](https://blogs.worldbank.org/eastasiapacific/ending-poverty-in-china-what-explains-great-poverty-reduction-and-a-simultaneous-increase-in-inequality-in-rural-areas#:~:text=Since%201980%2C%20the%20country%20has,rural%20China%20(figure%201))

(Figure 1, Life expectancy in China 1970-2010)

The exact causes of this unprecedented growth are still debated, but most economists and scholars agree that they had their origins in the economic reforms that the Chinese pursued in the 1970s and 1980s. This essay investigates two key reforms: the household responsibility system and the institution of township and village enterprises as sources of economic growth. It also discusses these reforms in light of China's state ideology, and demonstrates the difficulty of understanding the Chinese economy through a simple lens of either "socialism" or "capitalism".

The Chinese economy inherited by the socialist government after the Chinese Communist Revolution in 1949 was immensely poverty stricken. The majority of the population - nearly ninety percent - lived in rural areas, many on single family farms. Industrial production accounted for just 12.6% of GDP<sup>4</sup> - life in rural areas was difficult. Moreover, the country was badly damaged following a disastrous civil war. In keeping with socialist economic theory, the Chinese Communist Party sought to pursue an industry-heavy top-down form of economic development to rebuild and modernize China<sup>5</sup>. Because agricultural productivity was crucial to supporting the large population necessary for a rapidly expanding and industrializing economy, the Chinese government pursued a strategy of agricultural collectivization, a system where agricultural yields were publicly owned and distributed. There had been much debate over how collectivization would be organized, ranging from small to large-scale unification. This policy was intended to make the agricultural sector more productive while also ensuring that produce was distributed equitably.<sup>6</sup>

In its initial stages, collectivization proved to be successful. Between 1952-58, total agricultural productivity (agricultural outputs/inputs) increased by almost 28 percent.<sup>7</sup> Much of the reason for this success was due to the reorganizing of the countryside into voluntary cooperatives, in which farmers could opt in or out of cooperatives in hopes of a higher yield. Most of these early cooperatives took the form of "elementary cooperatives", consisting of 20 or 30 households. This allowed the agricultural sector to take advantage of economies of scale and improve efficiencies. However, this changed when initiatives to push for larger-scale collectivization began in 1958. 753,000 collective farms were transitioned into fewer than 24,000 large communes, and private plots were prohibited. Worker compensation was minimal, with it

---

<sup>4</sup> Lin, Justin Yifu. "Collectivization and China's Agricultural Crisis in 1959-61" *The Household Responsibility System* - JSTOR. <https://www.jstor.org/stable/1566543>. (1230-1233)

<sup>5</sup>Chen, Jie. "The impact of reform on the party and ideology in China." *The Journal of Contemporary China* 4.9 (1995): 22-34.

<sup>6</sup> Tuser, Claudia. "The Hukou System: Mao Zedong and beyond [04.06.2013]." *Academia.edu*, 13 Jan. 2015, [https://www.academia.edu/10146135/The\\_Hukou\\_System\\_Mao\\_Zedong\\_and\\_Beyond\\_04.06.2013\\_](https://www.academia.edu/10146135/The_Hukou_System_Mao_Zedong_and_Beyond_04.06.2013_).

<sup>7</sup> Lin, Justin Yifu. "Collectivization and China's Agricultural Crisis in 1959-61" *The Household Responsibility System* - JSTOR. <https://www.jstor.org/stable/1566543>. (1230-1233)

being mostly based on subsistence needs. Management was based on a “work point system”, in which “points” were allocated for work done by farmers around the cooperative. However, it was extremely difficult to measure and track the points, leading to a general lack of compensation for work done by farmers. Subsequently, farmers lost incentive to produce higher yields, as the return from the government would be the same regardless of the total amount they produced.

Agricultural collectivization also had disastrous consequences. Scholars have blamed the “Great Leap Famine”, a widespread famine which lasted from 1959 to 1961 and was responsible for a staggering 30 million deaths, the largest such famine in history, on China’s policies of collectivization. There have been many hypotheses for the famine, including: bad weather, a reduction in sown acreage, and the government diverting resources from agriculture and towards heavy industry. However, economist Justin Lin argues that the ultimate cause was that peasants could not exit the commune and thus had no incentive to perform extra work as participation was compulsory.



(Figure 2: China’s Great Famine, 1958-1962)

After Chairman Mao’s passing in 1976, power shifted to more moderate policymakers. Chairman Mao was the first president of the People’s Republic of China. He was an ideological hard-liner, unbudging in his pursuit of achieving collectivization, bringing with it consequences such as the Great Famine. His passing left an opening for change within the Chinese government, and certain individuals saw this. Most notable among them was Deng Xioping who became the country’s leader in 1977. The new leaders recommended sweeping changes in rural

policies, with distinct elements of these changes consisting of expansion of free markets, economic diversification, and an increase in procurement prices.

However, not all of China's reforms came from a top-down government mandate. In the fall of 1978, a small village in Xiaogang set up a secret agreement to divide communally owned farmland into individual sections - that they each worked - called "household contracts". This mode of agricultural organization would later be called the "household responsibility system" (HRS). The system was based on the concept of contracting plots of land to farmers, families and villages who would be responsible for profits and losses they incurred. At the time, this would have been regarded as a hefty "counter-revolutionary crime" as it was initially considered to be the reverse of collective farming, and thus was prohibited. Therefore, the members of each family exchanged children, so if one of them were to be caught, their families would not all be taken away. Witnessing the success of this system, neighboring villages and towns began adopting it. Soon, the government conceded the existence of this system, but required that it be confined to very rural regions where farmers had lost faith in the collective system. However, rich regions welcomed the new system just as enthusiastically as poor ones, and eventually this system became the model for the household responsibility system and spread across China. At this point, the central authority had no choice but to legalize the household responsibility system, as the collective system was essentially no longer in use.<sup>8</sup>

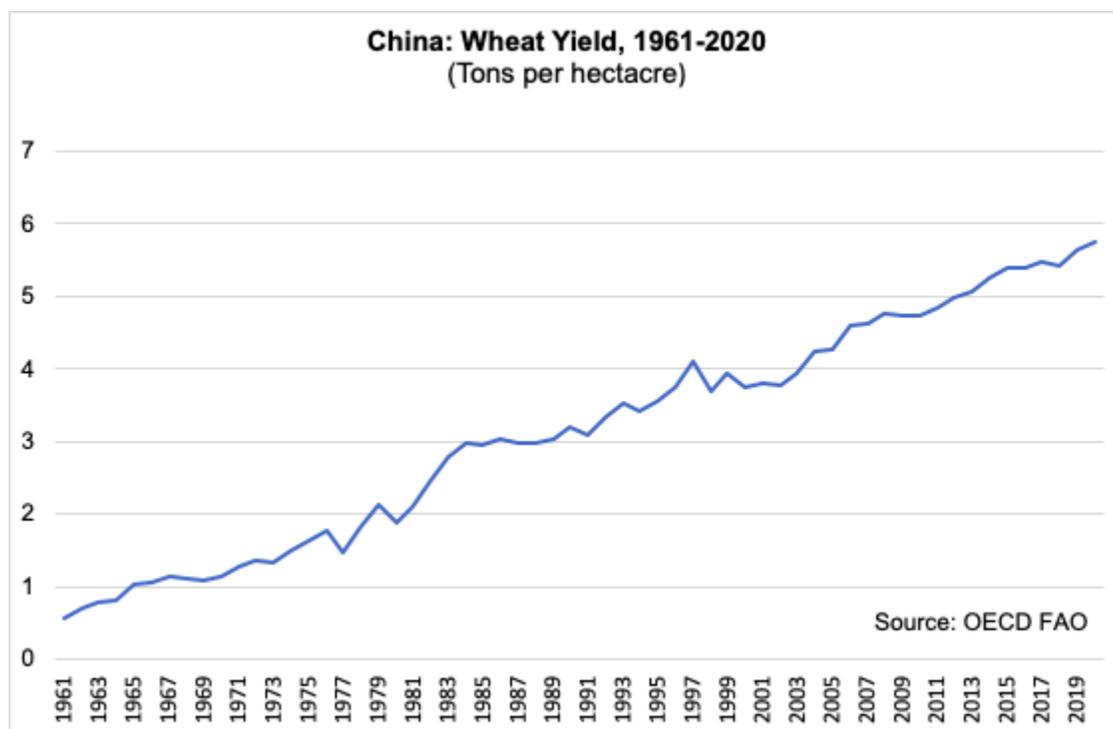
The specifics of the first instance of the HRS are largely unknown, given that it was a village-run system held in secret. However, the rapid spread of this contractual system in which profits and losses were attributed to respective families' land was leased to eventually lead to its adoption and implementation within Chinese society. In the Household Responsibility System, farmers as independent entities could contract collective land and undertake large-scale projects according to contracts that they made with the local government. Except for a small part of their profits, which were, as stipulated in the various contracts, paid to the state in taxes, farmers were entitled to all income that they earned through their work

The liberation of productive agricultural forces greatly increased output, signified by multiple statistics. The average prices of China's agricultural sector increased by 42.23% in constant prices from 1978 to 1984, of which 46.89% was due to the switch in production systems. From 1979 to 2019, the added value of China's primary industry increased by 4.3% annually, and grain output increased by 1.9% annually. In 2019, China produced 663.84 million tons of grain, 77.59 million tons of meat, 33.09 million tons of eggs, 32.01 million tons of milk, 64.8 million tons of aquatic products, 72.03 million tons of vegetables, and 27.40 million tons of

---

<sup>8</sup>Lin, Justin Yifu. "The Household Responsibility System in China's Agricultural Reform: A Theoretical and Empirical Study." *Economic Development and Cultural Change*: 36(3). p. 200-202  
<https://www.jstor.org/stable/1566543>.

fruits.<sup>9</sup> The production of wheat, an important staple crop in China, also grew dramatically during this period. The sheer scale of China’s population means that it needs to produce massive amounts of produce in order to feed its people. The fact that it is able to produce agricultural products in such large quantities for both its domestic market as well as for export is a testament to the successes of the reforms which began in the early 1980s, as well as a silencing of many original critics of the system.



(Figure 3: Explosion in China’s Wheat Production, 1961 to 2020)

Following the success of the household responsibility system, which led to the devolution of heavily state owned farms to smaller scale private actors, one might think that China’s economy in the 20th century followed a complete strategy of liberalization. This is not completely true. While market forces were at play, the economy – both in the primary and secondary sectors – was still heavily collectivized. The most notable example of this would be State-Owned Enterprises, typically abbreviated SOEs. State Owned Enterprises are companies controlled by the Chinese government and are prominent in strategically important sectors: such as energy, telecommunications, and banking. The Chinese government also maintains policies beneficial to SOE’s such as access to cheaper financing.

<sup>9</sup> “How Household Contract Responsibility System Promotes Poverty Alleviation?: Center for International Knowledge on Development, China (CIKD).” *How Household Contract Responsibility System Promotes Poverty Alleviation?* | Center for International Knowledge on Development, China (CIKD), <http://www.cikd.org/english/detail?leafid=217&docid=1603>.

It should be noted that State Owned Companies are not exclusive to China, or to socialist economies more broadly. For example, the US Postal Service can be considered a State Owned Enterprise. Chinese SOE's are unique, however, in their overall importance in the national economy. During the 1980's and 1990's, an important period in the economic development of China, SOE's comprised the vast majority of government revenue. Contemporarily, one hundred fifty thousand State Owned Enterprises account for nearly one fifth of urban jobs and 25% of national output.<sup>10</sup>

**Contribution Shares to Government Revenue By Ownership:  
1988-1995, (%)**

	1988	1990	1993	1994	1995
State-owned firms	71.6	71.3	71.6	71.4	71.1
Collective firms (includes TVEs)	19.7	18.6	17.3	17.3	17.2
Households	5.8	4.7	5.5	5.6	6.1
Other ownership	2.9	5.4	5.6	5.7	5.6

Source: SSB (1997; 238), cited in Perotti, Sun, Zou, 1998

(Figure 4: Importance of SOE's for Government Revenue, 1988-1995)

However many of these state-owned firms faced several inefficiencies. One was inherent in the ownership structure of the SOE itself. An SOE, by definition, is owned by the people, meaning the 1.2 billion Chinese citizens at the time. Of course, there was no feasible way for 1.2 billion people to have influence and control over a singular enterprise. Within this ambiguous ownership structure, those who had direct control of the firm's assets could behave in an opportunistic manner as there was little oversight or guardrails. Examples could include asset stripping from managers or shirking by workers. To mitigate these negative effects, the state, in practice, has taken tighter ownership control over the enterprises. As Enrico Perotti argues, this creates a moral hazard problem for the lower-level officials in that there is an asymmetry between "the lower jurisdiction that extracts value from the SOE pool and the higher jurisdictions that replenish that value." (Perroti, Sun, Zou, 1998). In a related issue, Chinese

<sup>10</sup> "Mor Money Mor Problems: China's Mixed-Ownership Reforms in Practice." *MOR Money MOR Problems: China's Mixed-Ownership Reforms in Practice* | Center for Strategic and International Studies, <https://www.csis.org/mor-money-mor-problems-chinas-mixed-ownership-reforms-practice>.

SOE's did not have to completely consider the costs of the project as the losses from the project were to be borne by the state. This led to some SOE's making inefficient investments.<sup>11</sup>

Such issues led to calls for either SOE reform or a development of a new means of economic production and distribution, preferably one that was not as top-down as the SOEs were and subject to various organizational problems. The growth and liberalization reforms in the agricultural sector provided an encouraging model. It was difficult to supply China's large and spread out population, though increasingly concentrated in urban areas, with various industrial and household products. As incomes, particularly for agricultural workers following reform efforts, increased, demand grew as well, providing more logistical challenges. Thus, the government laid out the framework for the Township-and-Village Enterprises (TVE) policy.

This new policy encouraged the development of private and joint venture enterprises as well as enterprises run by communes and villages (also known as TVG's, or town and village governments). It was also in this year that the rural industry formally gained its name of TVE. A critical part in why the TVEs became more economically efficient compared to its SOE predecessor was the fact that TVEs were under the direct jurisdiction of their TVGs and not local administrators who had ulterior motives and reported to higher ups in the party. This also allowed for community involvement, as it created incentive for members of respective TVGs to monitor and help TVE management due to the fact that the community now possessed the right to derive short and long-term benefits from their local TVEs.<sup>12</sup>

TVEs developed agricultural, industrial, commercial, construction, transportation, and service industries simultaneously. In addition, the restrictions of "three locales" (on-site acquisition of materials, on-site processing, and on-site sales) were removed, so that TVEs could extensively introduce foreign and domestic connections to increase supplies of products and industrial inputs.<sup>13</sup> In a similar way to the Household Responsibility System, TVEs essentially decentralized the means of producing and selling non-agricultural goods and services in China, allowing for more freedom in terms of economic development.

During this period, a number of preferential policies were introduced to accelerate the development of TVEs. By 1988, the total number of TVE reached 18.88 million (Figure 6), the total number of workers employed by TVEs was 95.46 million, and the gross income from TVE was 423.2 billion RMB. The average annual increase rates of the four years were 52.8%, 4.5%

---

<sup>11</sup> Jefferson, Gary H 1998. China's State Enterprises: Public Goods, Externalities, and Coase. *American Economic Review*, 88, 2: 428-32

<sup>12</sup> Chang, Chun and Yijian Wang. 1994. The Nature of Township-Village Enterprises. *Journal of Comparative Economics*, 19, 3: 434-52

<sup>13</sup> "How Household Contract Responsibility System Promotes Poverty Alleviation?: Center for International Knowledge on Development, China (CIKD)." *How Household Contract Responsibility System Promotes Poverty Alleviation? | Center for International Knowledge on Development, China (CIKD)*, <http://www.cikd.org/english/detail?leafid=217&docid=1603>.

and 60.9% higher than the 1978 figures, respectively. TVEs also assumed an important place in the national economy. The GDP from TVEs reached 2074 billion Yuan (US\$ 249.9 billion) in 1997, which accounted for 27.7% of the national GDP. The taxes paid by TVE totaled 152.6 billion Yuan (US\$ 18.4 billion), 20.4% of the national total. Now the activities of TVE cover almost all sectors of the economy, and the products of TVE have taken a large share of the economy in many fields. TVEs account for the production of 40% of coal, 40% of concrete, 43% of food and drinks, and 80% of clothes in the total economy. One third of total Chinese exports come from TVEs.<sup>14</sup>

	1990		1995		1996		1997	
	TVE	Share (%)	TVE	Share (%)	TVE	Share (%)	TVE	Share (%)
Total Value Added (billion Yuan RMB)	250	14.2	1460	25.3	1766	26	2074	27.7
Industrial Value Added (billion Yuan RMB)	186	27.1	1080	43.7	1263	44.2	1504	47.3
Taxes (billion Yuan RMB)	27.5	9.7	128	24.9	153.6	25.4	152.6	20.4
Exports (US\$ billion)	8	12.9	50.2	33.7	53.9	35.7	84.7	36.1

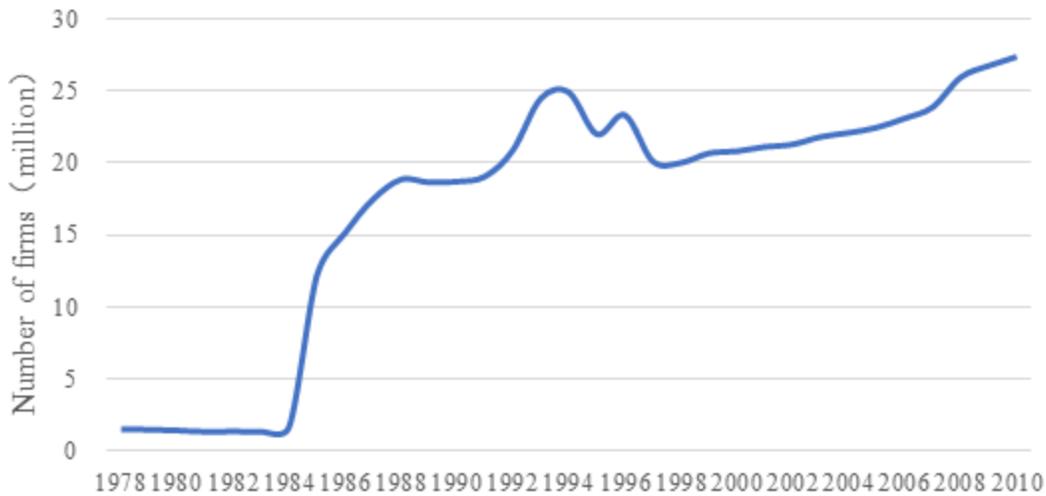
Source: Bureau of TVE, Ministry of Agriculture, Journal of China's TVE issue 10, 1998

(Figure 5: Economic Contributions of Chinese TVEs, 1990-1997)

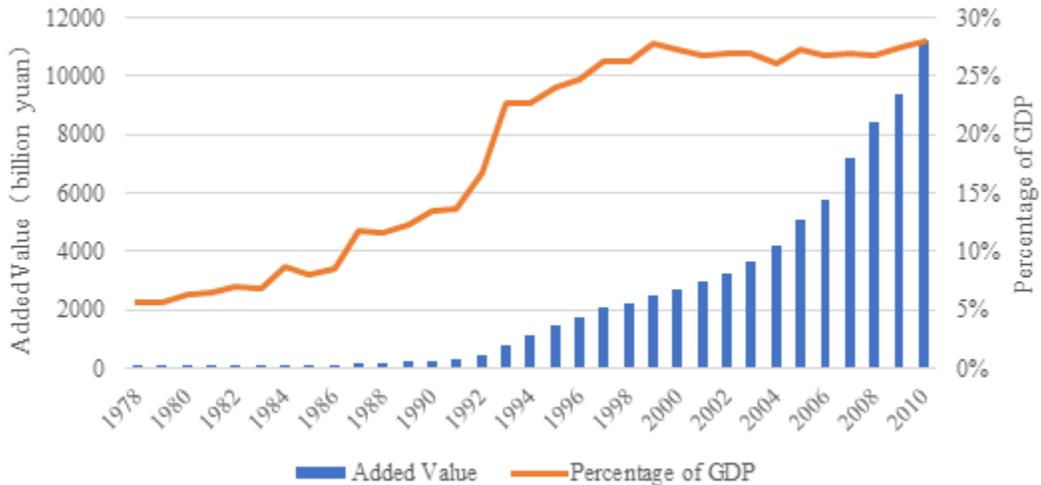
The success of decentralized enterprises with limited state control might imply that western-style liberal economic reforms were the cause of China's economic growth. However, we must acknowledge the fact that TVEs were still communally owned - without a concrete ownership structure. Collective owners do not usually have clearly defined shares, nor are there residual control rights compared with firms in America or Western Europe. Additionally, individual 'owners' have no way to sell, inherit, or transfer any part of TVE assets. TVE export growth has been one of the most impressive areas of development for this sector: it is estimated that TVE's total export value has had an annual growth rate of 26.5% at its peak.<sup>15</sup> Yet such exports have largely been contributed by those TVEs with dominant community ownership. Thus, there is an obvious contradiction with the outstanding performance of TVEs and the outcome predicted by traditional western property rights theory, one in which joint ownership not only is able to stay on par with private enterprises' growth rates, but far surpass them.

<sup>14</sup> Zuo, Ch. S. "Township and Village Enterprises in China's Sustainable Development", *Area Studies - China Regional Development Review* Volume 3, 2009

<sup>15</sup> Sun, Gu, and McIntyre. 1999. "The Evolutionary Dynamics of China's Small- and Medium-Sized Enterprises in the 1990s" (UNU/WIDER)



(Figure 6: Number of TVE firms operating in China, 1978-2010, CIKD)



(Figure 7: Added Value and Percentage of total GDP from TVEs, 1978-2010, CIKD)

The immense size of China's economy today compared to where it was 70 years ago can be attributed to a vast array of factors, including population growth, culture, trade, and technology. However, it is evident that policy reforms such as the HRS, TVE, and SOEs have played a critical role in China's economic success story. What we can see throughout the progression of economic policies in China is an experimentation with markets, liberalization, and public vs private. The early stages of China's economic reform after the Revolution often consisted of mass collectivization and industrialization, following the Soviet-Style socialist model. The household responsibility was an early victory in China's period of economic reforms and liberalization. Its success in increasing agricultural output clearly showed its advantage over earlier experiments in collective agriculture. The willingness to extend elements of the household responsibility system such as decentralization and liberalization led to initiatives like the

township and village enterprise system and transformed sectors outside of agriculture like commerce, industry, and transportation.

Many may look at these reforms and infer that China is or was simply adopting a Western style of economic production and that liberalization has been the root cause of China's stratospheric growth in the second half of the twentieth century. However, in many cases these reforms were less about ideology and more about economic efficiency. China still proclaims to follow the same core values that Chairman Mao established after the Revolution. This implies that reforms to promote economic growth do not always equal fundamental ideological change. What we can correctly take away from these policies and their results are that regardless of the debates around whether or not China "westernized" in a sense, allowing individual workers to take control of their work and feel as though they are in control of what they produce have led to immense increases in economic output that is transparent today.

## WORKS CITED

Lu Feng, Peng Kaixiang. "A research on China's long-term rice prices (1644–2000)". *Front. Econ. China*, 2006, 1(4): 465–520 <https://doi.org/10.1007/s11459-006-0017-2>

"How Household Contract Responsibility System Promotes Poverty Alleviation?: Center for International Knowledge on Development, China (CIKD)." *How Household Contract Responsibility System Promotes Poverty Alleviation? | Center for International Knowledge on Development, China (CIKD)*, <http://www.cikd.org/english/detail?leafid=217&docid=1603>.

Hays, Jeffrey. "Agriculture in China under Deng Xiaoping." *Facts and Details*, <https://factsanddetails.com/china/cat2/sub7/item347.html>.

Meng, Xin, et al. *The Institutional Causes of China's Great Famine, 1959–1961*. <https://www0.gsb.columbia.edu/faculty/pyared/papers/famines.pdf>.

Huang, Jikun, and Scott Rozelle. 24. *China's 40 Years of Agricultural Development and Reform*. [https://www.researchgate.net/profile/Jikun-Huang/publication/326492289\\_China%27s\\_40\\_years\\_of\\_agricultural\\_development\\_and\\_reform/links/5c637b4f299bf1d14cc1fa40/Chinas-40-years-of-agricultural-development-and-reform.pdf](https://www.researchgate.net/profile/Jikun-Huang/publication/326492289_China%27s_40_years_of_agricultural_development_and_reform/links/5c637b4f299bf1d14cc1fa40/Chinas-40-years-of-agricultural-development-and-reform.pdf).

C Perotti, Enrico, et al. "State-Owned versus Township and Village Enterprises in China." <https://web.archive.org/web/20070610200648/http://www.wider.unu.edu/publications/wp150.pdf>.

Lin, Justin Yifu. "The Household Responsibility System in China's Agricultural Reform: A Theoretical and Empirical Study", *Economic Development and Cultural Change*, 36(3), 1988, S199-S224. <https://www.jstor.org/stable/1566543>.

McMillan, John, et al. "The Impact of China's Economic Reforms on Agricultural Productivity Growth: Journal of Political Economy: Vol 97, No 4." *Journal of Political Economy*, 1 Aug. 1989, <https://www.journals.uchicago.edu/doi/abs/10.1086/261628>.

Nee, Victor and Rebecca Matthews. "Market Transition and Societal Transformation in Reforming State Socialism." *Annual Reviews*, <https://www.annualreviews.org/doi/abs/10.1146/annurev.soc.22.1.401>.

"U.S. GDP Growth Rate 1961-2022." *MacroTrends*, <https://www.macrotrends.net/countries/USA/united-states/gdp-growth-rate>.

"Ending Poverty in China: What Explains Great Poverty Reduction and a Simultaneous Increase in Inequality in Rural Areas?" *World Bank Blogs*, [https://blogs.worldbank.org/eastasiapacific/ending-poverty-in-china-what-explains-great-poverty-reduction-and-a-simultaneous-increase-in-inequality-in-rural-areas#:~:text=Since%201980%2C%20the%20country%20has,rural%20China%20\(figure%201\)](https://blogs.worldbank.org/eastasiapacific/ending-poverty-in-china-what-explains-great-poverty-reduction-and-a-simultaneous-increase-in-inequality-in-rural-areas#:~:text=Since%201980%2C%20the%20country%20has,rural%20China%20(figure%201))

Chen, Jie. "The Impact of Reform on the Party and Ideology in China." *Journal of Contemporary China*, 4(9), 1995, 22-34. <https://www.tandfonline.com/doi/abs/10.1080/10670569508724221>.

Zimmermann, Christian and Gary H Jefferson. "China's State Enterprises: Public Goods, Externalities, and Coase, By." *American Economic Review*, American Economic Association, 1 Jan. 1998, <https://ideas.repec.org/a/aea/aecrev/v88y1998i2p428-32.html>.

Chang, Chun, and Yijiang Wang. "The Nature of the Township-Village Enterprise." *Journal of Comparative Economics*, Elsevier, 1 Jan. 1994, [https://econpapers.repec.org/article/eejcecon/v\\_3a19\\_3ay\\_3a1994\\_3ai\\_3a3\\_3ap\\_3a434-452.htm](https://econpapers.repec.org/article/eejcecon/v_3a19_3ay_3a1994_3ai_3a3_3ap_3a434-452.htm).

Zuo, Ch. S. "Township and Village Enterprises in China's Sustainable Development", *Area Studies - China Regional Development Review* Volume 3. 2009 <https://www.eolss.net/Sample-Chapters/C16/E1-54-30.pdf>.

Zimmermann, Christian and Sun & Gu Laixiang. "The Evolutionary Dynamics of China's Small- and Medium-Sized Enterprise." *WIDER Working Papers*, United Nations University, World Institute for Development Economic Research (UNU-WIDER), 2 Feb. 1999, <https://ideas.repec.org/p/ags/widerw/295409.html>.

Tuser, Claudia. "The Hukou System: Mao Zedong and Beyond [04.06.2013]." *Academia.edu*, 13 Jan. 2015, [https://www.academia.edu/10146135/The\\_Hukou\\_System\\_Mao\\_Zedong\\_and\\_Beyond\\_04.06.2013](https://www.academia.edu/10146135/The_Hukou_System_Mao_Zedong_and_Beyond_04.06.2013)