

2. Central Planning before 1978

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Topics

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1 The specter of communism

Marx's diagnosis of the fundamental flaw of capitalism

- Insufficient aggregate demand causes in periodic economic crises
- Root cause: private ownership and income distribution favored to capital
- Shrinking income share of labor weakens demand
- Profit-driven capital accumulation expands supply

Marx's prognosis

- Public ownership
- Central planning
- The state can spend the “surplus” to keep demand in line with supply
- The view of historical materialism: slave society -> feudalism -> capitalism -> socialism -> communism
- Marx's prognosis has been proven wrong by the post-WWII global experience, while the problem of insufficient aggregate demand has been partially resolved by Keynes and a modern version of capitalism with social insurance and socialist spending

Socialism and communism

- Socialism:
 - From each according to his ability (everyone has to work)
 - To each according to his labor (no profits and exploitation)
- Communism:
 - From each according to his ability (no profits and public ownership)
 - To each according his needs (equal consumption regardless of income and wealth)

Key points

- Marxism emerged in the middle of the 19th century in response to periodic economic crises
- The same problem was solved by Keynes within capitalism
- Private ownership is the root cause of exploitation and insufficient demand
- Central planning with public ownership is superior to capitalism

2 How does central planning work?

Comparison of market and planning

- Planning needs centralization, while market is based on decentralization
- Planning requires detailed information, while market relies on prices
- Planning is effective with well-defined targets, while market is good for diverse tastes of consumers
- Planning requires strict discipline and external motivation, while market is driven by self-interests

Institutions of central planning

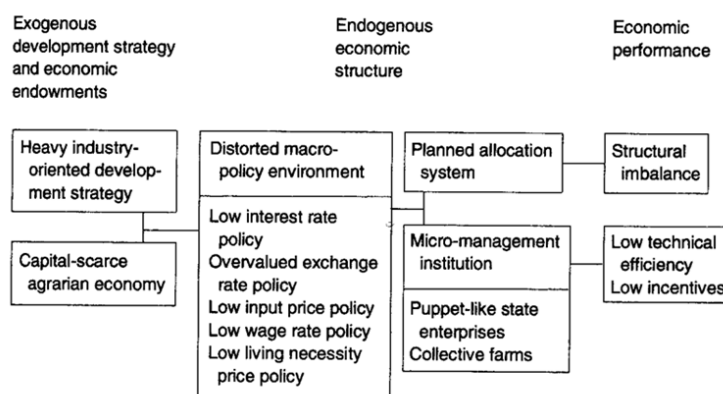
- Government planning agencies
- State owned enterprises (SOEs):
 - No profit motive
 - Responsible only for production
 - A self contained social cell
- Communes and collective farming in rural areas

Features of central planning

- Prices play no essential role in guiding allocation of resources
- The state collects revenue from profits and fund investment and other spending directly
- The financial sector is primitive
- The state monopolizes foreign trade
- The exchange rate is overvalued
- Regions are encouraged to be self-sufficient to minimize the need for cross-region planning

Central planning and heavy industry-first strategy

Figure 2.2 Formation of the Traditional Economic System in China



Key points

- The Party and the state controls all aspect of life and work through public ownership
- The control structure is top-down, and there is no need for horizontal interaction between independent agents or firms
- There is no need for market prices
- Loyalty and obedience are essential, so individualism and self-interest must be suppressed
- There is no need for a financial system to channel saving to investment
- Money, wealth, and individualism must be suppressed
- The ruler and the Party are supreme, while individuals are merely pawns

3 Why did central planning fail?

“Achievements” in 1949-1977

- Economic recovery: 1949-56, stripping landlords and capitalists of their land and properties
- The “Hundred Flowers” and anti-rightist crackdown of 1956-57
- The Great Leap Forward and famine, 1958-60
- Liu Shaoqi and Deng Xiaoping stepped forward to clean up the mess, and the third front construction: 1961-66
- The Cultural Revolution and “climbing up mountains and going down to the countryside”: 1967-76

Major events in 1949-1977

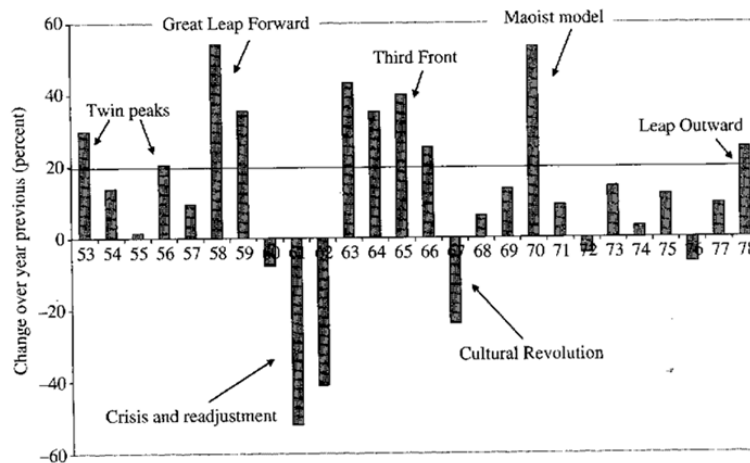
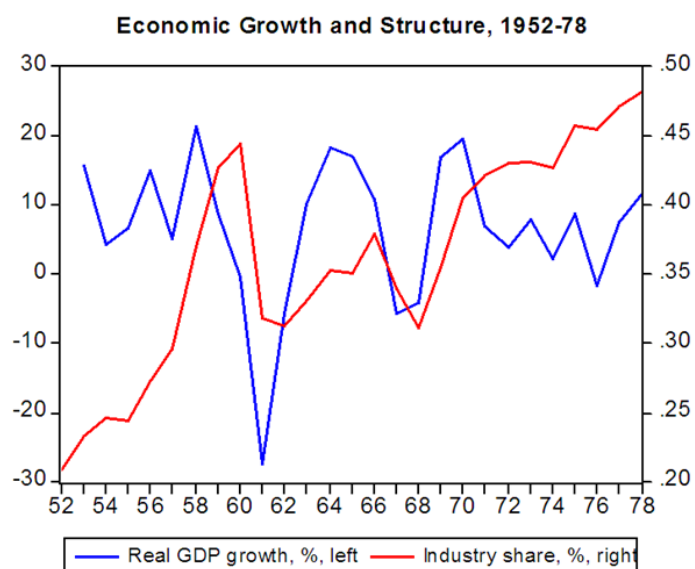


Figure 3.2
Growth of investment

The scoreboard of central planning

- High rate of investment
- Strong economic growth
- But Extensive shortage of consumer goods
- Low level of and slow improvement in living standard
- Widening gaps with East Asian tigers

Economic growth



Sectoral composition of output

Table 3.3 Sectoral Composition of National Income, 1952–1978
(in Nominal Price)

	1952	1957	1962	1965	1970	1975	1978
Agriculture	57.72	46.80	48.05	46.21	40.39	37.79	32.76
Industry	19.52	28.30	32.79	36.41	40.97	46.02	49.40
Other sectors	22.75	24.90	19.15	17.37	18.64	16.18	17.84

Source: State Statistical Bureau, *China Statistical Yearbook*, 1992, p. 35.

Slow consumption growth

Table 3.6 Changes in the Level of Consumption for Urban and Rural Residents*

Year	The National Income Index	The Consumption Index of all citizens	The Consumption Index of farmers	The Consumption Index of urban residents
1952	100.0	100.0	100.0	100.0
1957	153.0	122.9	117.0	126.3
1978	453.4	177.0	157.6	212.6

* The National Income Index and the Consumption Index are calculated on a comparable prices basis.

Source: State Statistical Bureau, *China Statistical Yearbook, 1993*, pp. 34 and 281.

Comparison in GDP per person with Asian neighbors, 2005US\$

	1952	1980	Annual compound growth
China	620	1,315	0.0272
Taiwan	1,469	7,674	0.0608
South Korea (1953)	959	4,561	0.0594
Japan	2,076	16,824	0.0776

Source: PWT 8.0

Comparison in per capita consumption with Asian neighbors, 2011US\$

	1952 (1953 for KOR, 1960 for HKG)	1978	2017	Growth in 1952-78	Growth in 1978-2017
China	964	1,435	5,709	1.54%	3.60%
Japan	2,479	10,922	30,864	5.87%	2.70%
Korea	982	3,421	22,595	5.12%	4.96%
Taiwan	1,557	5,664	32,359	5.09%	4.57%
Hong Kong	3,208	10,005	42,687	6.52%	3.79%
United States	11,863	21,073	45,726	2.23%	2.01%

Data source: Penn World Table 9.1

Why did China turn to reform and open to the world

- Too many machines and weapons, but not enough food and housing
- Backward technology because of economic isolation and lack of competition

- Efficiency loss because of not being able to become specialized according to comparative advantage
- After 1976, the nation became disillusioned with Mao's vision of a communist utopia and persecution in the name of "continuous proletarian revolution"

List of reform tasks

- Profit-driven enterprises
- Allocate resources according to market prices
- Free trade and free movement of productive factors
- Monetary, financial and fiscal systems
- Social insurance that takes care of the unemployed, the sick, and the old
- Divide the border between markets and the government

Key points

- Central planning with public ownership has failed in China as it has done elsewhere
- This is because:
 - Marx's solution to capitalism is flawed
 - Mao's paranoia of insecurity overrides the interests of the common people
- The right choice to make China great again is to turn towards an open market economy (capitalism)

Review questions

- What is the strategy to develop heavy industry first?
- How does central planning work?
- Why did Deng Xiaoping decide to lead China in a new path of reform and opening?