

Understand China's Miracle

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Abstract

As a very interesting example of institutions change China's reform since later 1970's has been widely studied. However the explanations on the China's miracle are largely varied between the scholars. This paper states that because China's reform is so unique, the current theories of institutions change are not very valid to explain China's reform experiences

China's reform did not followed Soviet Union's revolutionary reform model; China's reform is also neither a endogenous institutions change nor a enforcement institutions change, as many scholars claimed. This paper use a few key institutions change examples, such as rural area reform, raising of the private business, and SOE reform to demonstrate that China's reform is an authority leaded and guided experimental graduate change process. The political motivation of the reform and the fast accumulation on knowledge and human resources are largely contributed to the China's institutions change, but these factors are less discussed before.

China's institutions change is not an endogenous institutions change, as by definition, the endogenous institutions change should be a result of free institutional choices by all members of the society. This is not the case of China. Some reforms truly was initiated by the people, such as family responsible system reform in rural area. But it was the government decision to give the legal statue of this system and to allow this system to expand to the whole country. The initiation of family responsible system was raised before in 1950's and 1960's, but that time China's government killed it.

China's institutions change is also not an enforced institutions change, because the authority did not have a full institutions plan to force the whole society to accept it, at least not at the early stage of the reform.

The advantage and disadvantage of China's model are discussed in the paper. Both achievements made in last 30 years and the huge challenges China facing today can be explained by this unique institutions change format.

Path depended theory is the answer of why China followed her own unique way. The thousands years tradition and the social change experience in 20's century have the strong influences on the reform path choice. The paper also discusses if the Chinese classical philosophies could become the culture root for the modern China, just as the Enlightenment philosophies did for the modern Europe.

Key Words: China's reform, Institutions change, Path dependent,

1. Introduction

“The struggle of China is the struggle for the world” ----- Coase & Wang

“The most critical advantage China has its vast population of 1.3 billion enterprising, hard-working and persevering people. ---- Coase & Wang

“ That is the great story of our time. It is our story, everyone story---not just China’s”
<Time> 10/12/2008

The most unthinkable and unexpected fact happened in the contemporary era is the raising of the new economic and political power of China. This ancient “middle kingdom” achieved a tremendous performance in the economic development in her own unique way.

	1978	2013
GDP (in US dollars)	216 billion	9.24 trillion
GDP per capital (in US dollars)	318	7000,
Urban residence disposable income (RMB)	343	26955,
Pure income of peasants (RMB)	133	7907

Data Source : China Statistic Bureau and (Zheng, 2008)

From the neoclassical economic view the reason of these magnificent achievements is very obvious ----- the “China’s miracle” achieved by the factors accumulation: “Feng and Mason found that the demographic factor was thus favorable in China’s economic growth during the last quarter century. Cai and Zhao stated that the changes of the labor market, the transforming of the labor forces from the rural area to the cities; from the agriculture to the industrial; from the public sector to the private sector contributed the growth. Hannum, Behrman, Wang, and Liu claimed that the increased education level since the reform the ratio of tertiary school entrants to all senior secondary school students from less than 5% in 1980 reached above one-third in 2000 have the positive influence on he growth. Through the SEZs, Industry Development Parks, High Technology Development Park, and joint ventures, China was the largest FDI inflow country for many years. The FDI increasing rate is 27.55% from 1984 to 2007, and the amount the FDI reached \$75billions by 2007. FDI not only help China solve the capital shortage problem at the early reform time, also brought the new technology and the new management skills.” (Brandt & Rawski)

However the classical view is unable to answer the further questions: with similar demographic conditions why these factors did not be accumulated in the 1960’s and 1970’s? Why China started reform in the later 1970’s but not in the other time? Why China’s transforming experience is so different with the previous Communist countries, and why China’s modernization path did follow the western style as the role model?

Large amount research have approved that institutions matter for the economic development, For example, Ross Leven (1998), Glaeser et al(2004), La porta et al(2007), Acemoglu et al (2004) . Aron (2000) did a survey and found the measures of the economic development are significantly

correlated with: protection of property rights and enforcement(seven studies), civil liberties(ten studies); political rights and democracy(ten studies); political instability(15 studies); and institutions supporting cooperation, including trust, religion, and the extent of social clubs and associations (four studies). As North and Thomas put out: “the factors we have listed (innovation, economies of scale, education, capital accumulation etc.) are not causes of growth; they are growth”. In North and Thomas’s view, the fundamental explanation of comparative growth is differences in institutions. In the more recent years study by AJR also stated:” Economic institutions matter for economic growth because they shape the incentives of key economic actors in society, in particular, they influence investments in physical and human capital and technology, and the organization of production.” (AIR)

The 30 years reform of China obviously was not a micro-level efficiency enhancing improvement. It was a change for the whole economic system --- from the planned economic system to the market economic system. These economic institutions had been changed was enormous. Many researchers did the large amount studies to find out the relations between the institutions change and the China’s economic growth: Ye feiwen found that privatization, materialization contributed the economic growth 14.1% with1978-2001 data; Fu & Wu indicated that materialization and open reform contribute to the economic growth 35% (Xung de yi). Kong also approved that the change of the property right, materialization, distribution, and openness are statistically signification for the China’s economic growth from 1978 to 2006 (Kong). Bank of Finland conducted a research on the cross provinces economic performance study and found that the institutions quality is the cause of the differences in the economic performance in 31 Provinces by using the data between 1986 to 2002. (Bank of Finland)

These empirical works strongly demonstrated that the institutions change greatly contributed the China’s economic reform performance in the last 30 years. The further research should move to the study on the characteristics of the China’s institution change. This paper is focus on the field.

In section 2 the paper reviews a few key areas of the reform experiences in order to derive the special feathers of China’s institutions change. Then, in section 3 discuss the speacial features of the China’s reform, and in section 4&5 explains the influences of ideology and political motivation to the choice on the institutions. Finally the paper exams the impacts of the Chinese traditional culture to the current institutions choices.

2. Reviews on The Reform Experiences

“China became capitalism with marginal revolutions” ----Coase & Wang

(1) Privatization

Private business was abolished after CCP (China Communist Party) took over the power and did not obtained the legal position again until 1988. The raising of the private business was not just a matter of the economic institutions change, it was a political ideology issue. At the beginning of the reform the Chinese leaders had no intention to change the socialism system, but just wanted to

improve it. So the private business was only possible to be emerged at the “weak” places of the old system.

A). Rural area reform ---- from “the people’s county to the family responsibility contract system”
In 1950’s CCP implemented the people’s county system in the rural area. Land and all of other agriculture production materials belong to the people’s county and everyone share the harvest gain equally. The original purpose of this system was nice ---- to eliminate exploiting , but it was also very naive----it ignore the most basic human nature, that is people need the incentive to perform. People’s county did not had the clear property right and did not provide any incentive for the better work and better production. It is not surprise that this system later turned to be a disaster. “From 1950 to 1970, the agriculture production and the rural area consuming had been in the declining trend”(Li xingxi, p37-38). By the time of the reform start in 1978, there were already some peasants starving to death.

The institution’s change from “the people’s county” to the “family responsibility contract system” was not designed from the top. It was initiated by the hungry peasants. The well known story of “small hill village” has been mentioned in many China’s reform studies. In 1978 the village leaders and peasants took the risk of to be arrested to start the new production arrangement, that was to contracted land to the groups and families, and under this contracted system the more efforts would receive more rewarding. They had to worked with this new system secretly because the private farming was labeled as the “capitalism” that time and was illegal. One year later the production largely improved and this innovation finally be disclosed. Then immediately it caused huge ideology debate. Those doctrinal scholars, who never worried about their food, strongly criticism this new innovation as the “capitalism” and should be abolished, just like the government killed the similar innovation by the peasants in the 1950’s and 1960’s. Fortunately, this time the innovation received strong support from the reform leaders in Beijing. Finally in 1982 the government officially accepted the private farming as the complementary of socialism.

This institutions change seems modest and simple, but it provided the huge incentive to the peasants and bought the very significant results:

- the total agricultural production increased 55.4% from 1978 to 1984, the cereals production increase 33.6%and researched to the historical highest level .(Li xingxi)
- by the end of 1983, the family responsibility contract system was implemented in 95% rural population. (Coase & Wang)
- most importantly, the success of the agriculture reform approved that the private property right must be respected and people need the incentive to make the better effort. This inspired the further reform in other areas.

B). Town and Village Enterprise (TVE)

Town and Village Enterprises (TVE) received extensive attentions by the scholars and many research work discussed its role to the China's economic development. This was also a “weak controlled ” under planned system. The rural area private industrial business emerged from the TVE. According to Huang “ TVEs include enterprises sponsored by townships and villages, the alliance enterprises formed by peasants, other alliance enterprises and individual

enterprises.”(Huang)

From 1979 to 1989, there were several policies documents for encourage TVE, the output of the TVE increased 36 times from 1978 to 1992 and the share on the tax revenue from 4% to 14% (Li Xiao Xi) By 1992, the peasants net income 61.7% came from the TVE . By the early 1990's, TVE were contributing 40% of China's industrial growth and 40% of China's export. (Coase & Wang).

The advantage of the TVE comparing with the SOEs was less controlled by the central planned system and enjoyed the freedom on the sales, purchasing, and employment; while for SOEs all prospects of the production had to be decided by the planned system.

C). The raising of urban area private business

The starting of the private business in the cities was a accidental one. By late 1970's and early 1980's there was large amount “return youth” in the most large cities. These young people were sent to the countryside during the Culture Revolution and then they returned home without the jobs. “In some large cities, like Beijing and Tianjin, these “waiting for the jobs youth” account more than 10% population and this caused the huge social problem and the potential unrest of the society.” “China's government adopted the well known economists Xue Mu Qian's suggestion, that was to allow the unemployed young people to become self-employed” (Coase & Wang). This policy solved the pressure of the unemployment also boomed the urban area services industry.

Very soon this first generation entrepreneurs with very low education and low capital became much richer than the employees of SOEs and other state owned organizations. “The self-employed and household business increased from 140,000 in 1978 to 2.6 million in 1981. City residents started to enjoy goods and services that had not been available from the state-owned establishments. Those unemployed youth, now in 80's, become the highest income group”(Coase & Wang). So many state owned employees resigned jobs and joined the new born entrepreneurs teams. Some of these better educated entrepreneurs later became the owners of largest private companies, such as Lenovo's owner, Liu ChuanZhi. “The flood gates were now open for revival of private economy in urban China.” (Coase & Wang)

“For a long time the private business could not received the legal statue. Early stage government policy toward "individual economy “ three Nos ” ----- no promotion, no publicity, and no ban , compromise for maintain the socialism and solve unemployment. December 1982, People congress passed Constitutions amendment, individual business is a necessary complementary of the socialism economy. April 1988, Constitutions amendment stated that the private business is legal, is a necessary complementary of the socialist economy. In 1997, CPC 15th congress the private became the part of the socialism economic system. March 1999, Constitutions amendment the “ individual business, private business and any non-public business are the important parts of the socialism economy. By 2002, private business took 90% total employment, 50% total GDP, 37% tax revenue.” (Coase & Wang)

“ From 1980 to 1992, the non-state economy growth 40%, much higher than the 7.8% of state-owned economy. The weight of the non-state economy in the industrial output growth from

18% in 1978 to 67.5% in 1992 and the weight of the non-state economy in the value of industrial output from 22.4 in 1978 increased to 81.9% in 1992, but the state owned weight declined from 77.6% to 18.1%.” (Xung de yi)

The reason of such fast growing private economy is a simple economic logic: it provides the incentive. The operating environment for the private business is a pretty harsh one: long delayed legal statue, the discrimination on the financial resources and the human resources, the state protection on the SOEs monopoly, and the expropriations from the local or Central governments. The smart and hard working entrepreneurs survived from all of these. They are the heroes of in the China’s miracle story.

Table -1 shows the non state ownership steadily increased during the 30years reform.

(2) Materialization

In the planned economy system there were no any markets The basic three questions in the economy, what to produce, by how much, and for who, were all answered by the Central planning system. So the shifting from the planned economy to the market economy has to be a process of the building the markets for all production factors.

A) Productions markets

Since the reform China’s government gradually relaxed its control on the products markets. Firstly, in the early 1980’s government allowed peasants to sell their agricultural goods outside the government planned system, i.e. on the free market in the rural area. Later the industrial products produced by the TVE were also allowed to sell outside the planning system. For SOE, followed some young economist’s suggestion, China government adopted the “dual trick” system, i.e. to allow the market and planed system co-existing together. This way smoothed the transforming process for the planned system to the market system. But later this policy caused to the bad corruption problems. The “princes class”, i.e. the top leader’s children, conducted the arbitrage trading between the planned system and the market system.

Table 2, 3, 4, summery the result of the shifting from the government pricing to the market pricing. These tables indicate that by 2003 the change over from the planned economy to the market economy was almost completed in the products and material markets.

B). Labor market

Under the old planned system everyone’s job was assigned and fixed. Peasants belonged to their peoples county, and the urban residences also worked in the government's owned manufacturing or other kind of organizations. The job was fixed and had very low mobility. Since 1980’s, because the family responsibility contract system improved the productivity, the extra labor was allowed to shift to the TVE, or the industry sector. Later peasants was allowed to come to the city to work for the industry or services sectors.

In the cities, the raise of the private business and the reforming of SOEs simulated the demand for the labor markets. However the private employment was under the huge debate because under the

Communist ideology the private employment is regarded as “exploring” and the political goal of the CCP is to eliminate the exploring. The ideology argument delayed the development of the labor market. “Until 1986, the State Council issued “Temporary Regulations on the Use of Labor Contracts in State-Run Enterprises” and formally introduced labor contracts to the labor market. In 1994, China passed the Labor Law to take effect on January 1, 1995. The new law established a unified legal framework for labor relations and the safeguarding of worker’s rights.” (Brandt, Rawski)

C). Financial markets

Between 1950 and 1978, China’s financial system consisted of a single bank – the People’s Bank of China (PBOC), a central government-owned and controlled bank under the Ministry of Finance, which served as both the central bank and a commercial bank (Brandt, Rawsk) During the 1980’s the four state owned commercial banks, The Bank of China (BOC), The People’s Construction Bank of China (CCB), The Agriculture Bank of China (ABC), and The Industrial, and Commercial Bank of China (ICBC), were established and PBOC concentrated in it’s the role of the central bank. The financial services institutions for the rural area also developed, such as a network of Rural Credit Cooperatives (RCCs), Urban Credit Cooperatives (UCCs).

The establishing of the capital market was the major achievements of 1990’s . Two domestic stock exchanges (SHSE and SZSE) were established in 1992. Bonds markets, include government bonds market and the corporate bonds market, and the three commodities futures markets were also established in the 1990’s. Although the efficiency and the governance standards of these markets are still low, nevertheless, China established a comprehensive financial framework within such short time was worth to applaud for. .

(3) Deregulation the international trade system

Under the planned economy, “The State Planning Commission’s import plan covered more than 90 percent of all imports. The export plan was similarly comprehensive, specifying the physical quantities of more than 3,000 individual commodities. The Ministry of Foreign Trade were responsible for carrying out the import and export plans. In this context, neither exports nor imports were sensitive to exchange rates or relative prices. The volume of Chinese trade, relative to world trade, declined sharply from 1.5 percent in 1953 to 0.6 percent in 1977” (Brandt, Rawski)

Since 1980 international trade system started the reform. The state-owned companies gradually carrying the contract system reform, i.e. the self responsible the trading profit and loss. The license for the international trade was grounded to much more companies. The international trading companies from 12 at the beginning of the reform to 35000 by the mid 1990. Ten more years later any individuals business is eligible for the international trade.

3. Characters of the institutions change

China’s transforming from the planned economy to market economy is an unique one and was very different with the transforming of other previous Communism countries. The social and

political environments of China today do not really meet the requirements the basic economic development conditions according to the Washington Consensus. The outstanding development performance even challenged one of the commonly well recognized results of the institutional economic research, that is the property right protection is the pro-condition for the economic growth.

The current institutional studies classify the forms of the institutions change as either the endogenous change or the enforced change. But neither of them is very matched with the China's institutions change characters. The scale and scope of China's institutions change are so large it should not be expected that any single format can fit the China's experience perfectly. The large amount studies have indicated that the China's institutions change is mutual styled and changes with the time and locations.

(1). Early stage (1978 - 1992)

“crossing the river by groping for stones” ----Deng Xiaoping Ping

“China started its post-Mao journey, it has no road map in hand and no destination in mind”
(Coase & Wang)

Coase's statement is correct for the very early stage of China's reforms. The early stage reform policies were set up for responding to the crisis caused by the Culture revolution.

After the ten years “Culture Revolution” China was in the very critical conditions politically and economically

Economic crisis:

“two-third of peasants in 1978 had an income lower than that in the 1950s, and one third had an income even lower than that in the 1930s before the Japanese invasion of china.” (Coase & Wang). From 1966-1976, ten years Culture Revolution time, the salary of state-own enterprises employees declined , both urban and rural area suffered food shortage, the growth on the national production was negative. (Li Xiao Xi)

Political crisis:

However, these powerless peasants and workers did not caused any political crisis, the political crisis came from the inside CCP. During the Culture Revolution, large amount party and army leaders lost their position, many were even arrested for the political crime of “anti-revolution”, some lost their life. Those who survived from the Cultural Revolution demanded for the change.

Social crisis:

During the “Culture Revolution” the universities were closed and more than 10 millions of young students were sent to the countryside for “re-education”. “Probably no group more humiliation suffering under Mao than the intellectual” (Coase & Wang). Intellectual firstly were strongly attacked in the “anti-rightness” movement, then, again suffered much worst attacked during the Culture Revolution. Almost all of scientists, professors, teachers and the academic researchers

were sent to the countryside to work as the hard labor for the purpose of “re-education”, even worse, they were often beat up and insulted by the “Red Guards”. Some of them could not bear this harsh disgrace and choose to suicide, include several top scientists and scholars. “Culture Revolution” caused huge loss on the intellectual resources, the trust between the people and the people to the state, and the sense of the right or wrong was totally be upside down. The most tragic thing was that, the sense of kind, love, goodness, and humanity, these basic characters of human being and the long traditions in the Chinese culture history, were totally smashed by the religious fanatic of Red Guilds. This dark shade could influences to more than one generations of Chinese.

The reform was started without the sufficient intellectual perpetration and a blue printed plan. The government took the pragmatic approach. In this stage a lot of the changes were initiated by the ordinary people, such as the family responsibility contracted system reform in rural area, the merging of the private business, some reforming on the SOEs, and the free markets for the agricultural products. After the preliminary experimental, if the initiation was successful, or as long as it improved the agricultural or industrial production and the people’s living standard, then government would endorse it, used the official authority to expends it, and finally made it become the legislated institutions. However, the original institutions innovators often did not really participate the legislation process. “The result was that the 1980s was a decade of vibrant, grassroots, bottom-up entrepreneurship in China’s massive countryside. These reforms amount to nothing more than some relaxation of existing constraints on the private sector. No fundamental institutional reforms – those aiming at property rights protection” (Huang)

The key role in this responding style institutions change was a few reforming politicians who strongly support the people’s initiatives. They were not the designers of the institutions changed, but they were the ideology reformers. Because the reform started right after the Culture Revolution and the ideology debates on what should be changed and what should not was still very strong, some reform polices was criticized as the capitalism and was against Mao’s theory and socialism. So the early reform leaders took the large political risk to push the reform moving forwards.

The 1980’s reform was not only in the responding style, there were some government positively delivered institutions changes. The most successful one was the establishment of Special Economic Zones (SEZ). China’s government also took the experimental first then expand it format. In 1979, the four SEZ were set up and then in 1984 expanded in 14. The SEZ made the great contribution to the early stage reforming performance, it brought the large amount of the capital, update the technologies, and set the examples for the modern enterprise management.

1980’s reform is often be called as ‘no losers’ reform as the innovations of the change came from the self-interested searching of the grassroots level, the top leaders generally endorsed these innovations as long as these innovations could solved the economic and social crisis caused by the Culture Revolution, and also these “marginal revolution” possessed very little threaten to the formal political system. The economic benefit of the reform was largely distributed to the grassroots level, or to the those outside the public system and the gain of the central government

was the returned political trust from the people and the social stability.

(2) The 2nd stage (mid 1990 ---)

After 1989's "Tian an men Squire" event the reform progress in China was paused for a few years and the dogmatic ideology came back again. The 1980's reform was blamed for the happening of the "Tian an men Squire" event and some reform policies were reversed.

After the "south tour" of Deng Xian Ping at the end of 1992 the economic reform was started again. Although by then Deng already retired from the top leadership positions, but he was in fact still had the most powerful political influence in China. During this tour he sent out the message "whoever refuse the reform, who would be cleaned out from the leadership". After that the reform was revoked again.

Different with 1980's reform when both political and economic reforms were in the government agenda and both reforms were publicly discussed and debated in the official medias and also amount the intellectuals, in the new started reform in the early 1990's the political reform agenda was totally disappeared. The "Tian an men Squire" event and the collapse of the Soviet Union could be the causes of this political panic. The harmony relations between the authority and the public also disappeared. The government was no longer to set the reform policies by responding to the people's demands, rather ambitiously believed that by copying what other countries have done they could build the market economy from the top.

"In the 1990s, FDI, technology, national champions, massive infrastructural developments, and urban renewal were elevated to the top of the economic policy agenda. In each one of these areas, the state is perceived as an indispensable instrument to make things happen." (Huang)

During this period the market was attempted to be built by the visible hands. The advantage of this enforced institutional change was the speed, i.e. in a relatively short time to build the basic market economy's infrastructures, such as the banks, stock markets, real estate markets, etc. However, because the markets were supplied from the top rather than formed by the self-interested searching buyers and sellers, the very important elements in the market is missing, that is the incentive to the market activities. Some of the reforms were publicly claimed not for the benefit of the market participants but for the government itself. For example, the Shanghai and Shenzhen stock exchanges were set up in the early 1990's, but the designed purpose of the stock exchange was not for the more efficient capital allocating, rather was for the new financing source for SOEs. For a long time only SOEs are allowed to listed on the stock market. It could be imagined that this kind of stock exchange the investors protection is out of the consideration, and same time, it provided the huge opportunity for insiders to grasp the large amount of free rents. After a series of scandals, this wrongly designed stock market was strongly regulated since later 1990's. However, because enforcement of the law and regulations are weak, the rank of China in the investors protection index of the Global Competition Report is still low, ranked around 100 out of 155 countries.

If the first part of the reform introduced the most critical thing missed in the planned economic:

incentive. But the second part of the reform, built the something looks like the market economic, but missed the most critical telement in the market economy: **incentive**

Huang summery the reversing facts of the 1990's

- The economic and social implications of a more entrepreneurial version of capitalism in the 1980s and the one closer to state-led capitalism in the 1990s in fact differ enormously.
- In the 1990s, China reversed many of its productive policies of the 1980s, with real consequences, ...the income growth in rural China slowed down in the 1990s. In particular, business income growth – the income derived from owning and operating a business – slowed down drastically
- In the 1980s, the rapid GDP growth was accompanied by fast personal income growth, an improving income distribution, and a steep decline in poverty. Since the early 1990s, and at an accelerating pace since the late 1990s, the welfare implications of the fast GDP growth turned adverse.
- Although GDP growth was rapid during both the 1980s and 1990s, household income growth was much faster in the 1980s. The share of labor income to GDP was rising in the 1980s but declining in the 1990s.
- Many of the best-known achievements of the Chinese economy owe their origins to the policies of the 1980s and many of the deep-seated problems today are an outgrowth of the policies of the 1990s. (Huang)

Another interesting example was the selling off the SOE. After the unsuccessful reform of the SOEs in 1980s, Chinese government decided to took the police of “keep the big and let the small gone” to the SOEs. Large amount of the medium and small SOEs were sold off to the private investors and overseas investors with the prices below its value. This policy caused millions of SOE's employees lost jobs. The compensation provided by the government for this layoffs was very low and many of these layoffs later became the poverty populations of the cities. Those had been kept large SOEs received strong support financially and intellectually from the government and later developed to the top enterprises of China, some of them are at the top list of the Fortune 500. So this SOE's selling off police was recommended by some scholars as the necessary price had to be paid for the economic system change. However, by many research in recent years, the efficiency and the governance performance of the retained large SOEs were not that good. This policy would be only possible happened by the top designed reform, would never happened by the responding type reform. 1990's reform was no longer the “no losers” reform. Others policies, such as commercializing the education and medical care, also caused strong complain from the working class. So 1990's reform was not the reform which focusing the benefit for the gross-root level. Beyond the brilliant numbers, either efficiency and justice are all not that brilliant.

(3) Growth without the property protection

The important of the property protection for the economic growth has been extensively addressed in the financial academic research. The logical of this is very clear: without the property protection, the investors would worry the expropriation from the insiders and the authority.

AJR stated that the pro-condition of the long run economic growth is the good economic

institutions. They defined the good economic institutions as “good economic institutions as those that provide security of property rights and relatively equal access to economic resources to a broad cross-section of society,.....There must be enforcement of property rights for a broad cross-section of society so that all individuals have an incentive to invest, innovate and take part in economic activity.....There must also be some degree of equality of opportunity in society, including such things as equality before the law, so that those with good investment opportunities can take advantage of them”(AJR)

China achieved 30 years very good economic performance without such “good economic institutions”. So that many researches questioned the China achievements because it is not matched with the current research solution. “The Chinese legal system does not provide a secure system of property rights. Nor are rights secured by law when the legal system is unable to resolve conflicts between the rights bestowed by different levels and different arms of government.”“formal legal institutions have not made a critical contribution to China's remarkable economic success. The legal system, in fact, developed in the large degree after the Culture Revolution. “In 1983, five years into the reform era, China had only 8,600 full-time lawyers. By 2005, that number had increased to well over 100,000, and the year 2004 saw over 40,000 new LL.B. graduates (Clarke, Murrell, Whiting). In legitimization, for attracting the investment capital and the new technology, China, at the very early stage of the reform, set up the special laws for protect foreign business, such as Law on Sino-Foreign Equity Joint Ventures (EJV Law) in July 1979, Foreign Economic Contract Law (FECL) Law on Wholly Foreign-Owned Enterprises (WFOE Law), the Law on Sino-Foreign Cooperative Joint Ventures (CJV Law). The Contract Law was also passed for the transaction between the SOEs.” (Clarke, Murrell, Whiting)

The most weak legal protection was in the private sector. The WFOE Law, for example, allows for single-shareholder companies. Until the implementation of the revised Company Law in January 2006, it was not possible for any Chinese investor other than a governmental entity to be the sole shareholder in a Chinese company. “For a long time private business had to become the “red hat” enterprises: business formally registered as collective instead of private in order to qualify for benefits available only to the public sector and for protection against local government predation In October 1987, the 13th Congress of the CCP recognized the private economy (not just the economy of individual entrepreneurs) as a necessary supplement to the state sector, and in 1988 the Constitution was revised: to the existing acceptance of the “individual” economy was added the acceptance of the “private” (siying) economy “ (Clark)

If the legal protection is so low, why China’s private sector could developed so quickly? China’s private business are much less independent and are closed connected with the authorities, especially with the local governments. Local government officials, drove by the incentives of the fiscal revenue and the economic performance based promotion opportunity, has the motivation to push the local economic growth, so they delivered many “business friendly” policies. Further, most private business people all have some kind of relationships with the local authorities. Some business people are the family members or relatives of the local officials. If businessperson without any nature connections with the officials, they have to make one. That why the business in China has the reputation as the “relationship business”. This close attached money and power save

the legal cost of the legislation in the property protection, but became the major resource of the widely spread corruptions.

The relationship base protection may help some business avoid the expropriation from the authorities, but, for many ordinary people, the expropriation is hardly to escape. For the last 20 years, “qiangchai”, i.e. the forced demolishing the people’s property for the purpose of the property developing and the government renewal projects had caused large amount miserable cases. These powerless people some time not only lost the properties also lost their life. However, although the people’s property and life were all be destroyed, those rich property developers projects and local government infrastructures projects all contributed the GDP’s growth ! That is way in recent years many independent intellectual asked for “do not want GDP with the blood on it”

3. The role of the local government

The role of the local government in the China’s 30 years economic achievements is another hot research topic. “Two note worthy features of the institutional environment. The first is the cadre evaluation system that sets criteria for the performance of Party cadres and government officials, monitors their performance, determines their remuneration, influences their tenure in office, and shapes their opportunities for advancement. The second is the fiscal system that finances their activities and creates the revenues that are essential at the local level.” (Clarke, Murrell, Whiting). Many others shared this view and agreed that the economic performance based promotion and the new decentralized fiscal system since the 1994 are the two strong incentive for the local government to push the economic growth.

“When each of the local Chinese government, including 32 provinces level governments, 282 city governments, 2862 county governments, 1522 town and village governments, tests out its way of developing the economy. Numerous different experiments are conducted simultaneously, each in competition with the other.” (Coase) This competition made the local governments became the major institutions innovators, such as polices on FDI, the polices on industry and technology parks, the polices on the industry restructure, the police on the private business development, and the police on the SOE reform. etc. The advantage of the local government innovation is that the local officials have the better information and the better understanding on the local conditions and people. Because China is a large country and the conditions of different area largely varied, so the institutions innovation based on the local condition generated some very different successful institutions packages, such as SU Nan model, Wen Zhou model, and the Guangdong model, each of them has their own format to provide the incentive. The central government use the central political power to protect the growth of local protection, as the final appointment of the local officials are controlled in the CCP personal office.

The economic incentive was in the hand of the local government and they may pass some incentive to the entrepreneurs, but the local government, in the middle, obtained large opportunity to grip the free rent. What the consequences of this local government droved economic growth:

1st: the driving force of the economic growth is relying on the heavy investment:

Statistic shows that from 2001 to 2009 the local fixed investment growth 24.8% annually, comparing with the central fixed investment growth 10% annually. The weight of local fixed investment in GDP raised from 27.9% in 2001 to 61.2% in 2009. (Li, changli)

2nd low innovation

Coase gave a history review in his book "How China became the capitalism": UK, US, Japan all had the leading brands when these countries lead the world economy, even south Korea has a few leading brand name of the world. But, China, as the 2nd largest economy in the world, so far there is still hardly any the real world brand product. "This will set an unprecedented example in modern human history: the largest economy in the world will not be the most productive one." (Coase & Wang)

4. Ideology change during China's 30 years reform

"Immediately after the death of Mao, Chinese politics witnessed a swift and significant changes in both personal and ideology." --- Coase & Wang

North mentioned the importance of the ideology in his several works. "the ideologies and belief system that underlie the choices human make" (North 1994) "it is beliefs that connect "reality" to the institutions" (North 2003) "the institutions and beliefs of the past have an enormous effect on constraining the ability to make change in the present and the future" (North 2003). The important of ideology to the economy development has been well addressed by Max Weber. The change of the attitude to the work, wealth, nature, and fate were the per condition of the science revolution and industry revolution. Reill & Wilson believed that SCIENTIFIC REVOLUTION and the ENLIGHTENMENT contributed the "Industry Revolution". "In fact, the Industrial Revolution was a logical if not a necessary outgrowth of these two intellectual movements." (Reill & Wilson)

The 30 years China's reform was not just an economic reform, but was also a ideology and a political reform. The change of the ideology and the change of the economic institutions were mutually supported.

In CCP's long history, under the same Communist believing, there were always two controversial political philosophies: one, dogmatism; another, pragmatism. During the Culture Revolution, the dogmatism plus the Stanlin style cruel "class struggle" had put China into a deep political and economic crisis. After the death of Mao and the "Gang of the Four" was arrested, this dark chapter of the history eventually be closed and the more pragmatic leaders control the power. On May 1978, a important article was published : "*Practice Is The Only Criterion For Testing Truth*". This was a significant ideology shift, as in the past, the rightness of the ideology had to be only identified based on the Mao and Marx's book. This time ideology shift was recognized as the first "massive mind emancipation"

The Third Plenum of the 11th Central Committee in the later 1978 decided "to shift the emphasis of our party's work to socialist modernization and the growth of the productive forces." This declaration told Chinese people that the class struggle era was eventually finished. However, that time the influence of the Culture Revolution was still strong, both inside and outside CCP. The

new leadership wisely picked up the Mao's slogan "*seeking truth from facts*" to support this ideology shifting and by doing so they consolidated the contradiction between the dogmatism and pragmatism and maintained the political stability after the major shifting of the political philosophy.

The important ideological clarification during the "massive mind emancipation" included:

- Epistemology shifting ----from doctrinal to empirical. The truth should be found from the experience of the real life rather than from the words in the book. This shifting built the theoretical foundation for the responding style policy making.
- Released many intellectual and previous government officials who were wrongly sentenced to "political criminals" during the Culture Revolution. This rehabilitation on the old "anti-revolution" cases greatly contributed to the political stability and enhanced the political forces for the reforming. By then CCP was ready to its new mission: "Changing in all methods of management, actions and thinking to serve only the growth of the productive forces"
- Reopened the universities and pay respects again to knowledge and education. Changed the Culture Revolution's slogan "more knowledgeable, more against revolution" to the new slogan "the knowledge is power". This change over created the huge learning enthusiasm of the whole society. Not only the students were studied hard in the schools and universities, the workers, peasants, the factory technicians, and the government officials were all studied in all kind of night schools. This large scaled societal learning built the good foundation for the fast technology upgrade the fast moving from agriculture economy to the industry economy.
- From anti-material wealth to encourage getting rich by hard working. CCP new slogan "poverty was not the virtue of socialism" changed the people's attitude to wealth, and also CCP moved itself work task as the economic development, rather than the class struggle. This was the beginning change over for CCP from a revolution party to a governing party.

The shifting of the ideology was not a smooth one and also not a one step job. The argument of "what is the capitalism, what is the socialism" was going on all way through with every major economic institutions changes from the planned system to the market system. Most changes of the economic institutions did take place with the efforts of reform leaders, even under the ideological attacks. But there were also many purposed changes been canceled or delayed because of the ideology's reason. Coase & Wang in his book, "How China Became Capitalism" recorded in details how the pricing system reform failed in 1980's due to the ideology barrier.

Coase gave the reason why ideology barrier is so hard to move away: 'the dogmatic teaching of Marxism has cultivated a certain habit of thought, which has survived Marxism itself: the mentality to take truth as final, complete, permanent, and authoritative. But all empirical knowledge is exactly the opposite; it is provisional, incomplete, and conjectural' (Coase & Wang). Although CCP recognized the "*seek truth from fact*" is Mao's teaching, but when dealing with the real life problems, many government officials had very little practical reasoning ability, that could be the result of long time rigid dogmatic brain washing.

The "massive mind emancipation" in 1980's was a unfinished work and it is paused by the "Tian an men" event and seems it is never revoked again. So the thinking style of "take truth as final, complete, permanent, and authoritative" was saw again in the later years. The different styles of

the institutions changes in 1980's and in 1990's was also be related to the ideology. The leaders in 1980 firstly moved from the dogmatic ideology, accepted the true knowledge is from the practice, and respected the people's real life experimental is the best way to find the workable institutions. So although under the centralized political system, government's responding and endorsing role in the institutions changes gave the real game players in the economy, the framers, businessman, factory managers, the confidence and the freedom to innovate the institutions for their need and their benefits. The 1990's reversed role of the government in the institutions change could be the reverse of ideology. The leaders in 1990 no longer trusted the people to create their own institutions, so the authorities took the much more active role in the institutions supply, in both micro and macro levels. The "omnipotent and infallible" CCP can build the market economy by their powerful organizational capacity.

5. Political economic analysis

The current institutions research is still limited the economic incentive to explain the economic institutions choices. Within this theoretical framework it is hard to find the valid explanation on why China's leadership took the major role of the institutions supplier in the 30 year's reform.

China's 30years reform was not a just economic one, but also a political one, and in fact, the change of the political ideology had the strongly influence on the speed of the reform and the performance of the reform. The analysis on the China's 30 years reform has to be a political economic analysis rather a pure economic analysis.

In the 30 years reform the central government leaded the direction and steps of the reform, with and without the demand from the public. According to the AJR social conflict model, "economic (and political) institutions are not always chosen by the whole society (and not for the benefit of the whole society), but by the groups that control political power at the time (perhaps as a result of conflict with other groups). These groups will choose the economic institutions that maximize their own rents, and the economic institutions that result may not coincide with those that maximize total surplus, wealth or income." "political institutions play a crucial role in the social conflict view. Which economic institutions arise depends on who has political power to create or block different economic institutions ". (AJR)

The plausible contribution of AJR model is that it brings the political institutions into the economic performance analysis. North had pointed the mistake of the separation of social science almost 20 years ago "We do not live only in an economic world, a political world or a social world; we live in a world that is a blended mixture of all these " (D. North). But the most institutions research today are still narrowly limited the eyes on economic issues only.

The significant weakness of AJR model is that it still regards the economic rent as the sole motivation for the institutions choice and ignore the very frequent real life fact: beside the economic rent, the political goal and mission are also an important consideration for the political power holders when they make the institutions choice, and the China's reform experience is

another very good example on this fact. Without the understanding on political motivation in the institutions change the China's miracle cannot be explained clearly.

“In its early stage, Chinese economic reform had a rare advantage in the political establishment was largely free from vested interests” (Coase & Wang). That early stage reform was led mainly by the first generation of CCP who had survived from the many years tough civil wars and the nightmare of Culture Revolution. They were the men with the strong sense of mission and the strong will power. “The purpose of our revolution is for building the strong country”, that was the words of Xiaoping. So it is hard to assess that the first stage reform policies were self-interest oriented. In fact, the benefit of the early stage reform was mainly distributed to the grassroots level of the society. Of course, the “dual track” pricing reforming caused some corruptions and mainly the “prince class”, i.e. the children of the leaders involved this first wave of the corruption after the beginning of the reform.

To review the China's 30 years reform experience, one fairly obvious fact is that at each critical points of the reform CCP always played decisive role. Look the following a few examples:

- December, 1978, The Third Plenum of the 11th Central Committee: later always be regarded as the starting point of the reform. In this meeting the top leaders of CCP decided to stop the “class struggle” agenda and shift the political philosophy based to the “seek the truth from the fact”, a more practice and pragmatic approach, and moved the core of CCP's work to the economic development.
- January, 1982, CCP sent out the document and approved “family responsibility contract system”, After that this system be expanded to the whole country and, more importantly, the newly emerged private nature farming operation was endorsed by the socialism leaders. It marked the beginning of the birth of the private business in China again.
- October 1984, CCP the third plenum of the 12th central committee passed its document which, for the first time, accept market economy is not contradiction with socialism. Only after that the private business were treated as “legal”
- October 1992, the 14th Congress of CCP passed new CCP's constitutions and stated the to build the socialist market economy is the goal of CCP.

Up to here, the ideology barrier to the market economy was almost cleaned up.

Either in the China's own history or other countries, there are hardly any other examples of a single political party to be the major institutions provider. Why CCP took the leading and the control role in the reform?

“The pivotal goal of CCP are: *in power for a long time, economic development, political civilization, national rejuvenation*. Among these four, “*in power for a long time*” is the most important one. (Jing guojun) CCP led the reform with the political motivation rather than the

economic rent driving, although many officials did take the huge amount of benefits through the reform process. Why the reform is so important for CCP politically? This has to be explained from the CCP's history

With the long history and a rich civilization Chinese always pride to their position in the world for the past thousands years. However since the middle of 19th century China experienced many misfortunes. This, of course, was the result of long time civilization alienation. Many educated Chinese, influenced by the western philosophies, questioned the vapidness of the Chinese traditional political systems and demanded to abolish the emperor's ruling and to build the new society based on the western model.

However, in the early 20th century the western countries were not the good examples for the justice and fair society, and western countries forced China to sign many unfair treaties. This largely hurt the enthusiasm of learning from the west. After many ideologies been experimented and finally CCP, with the believing on Marxism Communism, won the ruling power after a cruel civil war.

AJR explained the how economic conditions influence the institutions choice: "why Britain evolved into a democracy, while Germany succumbed to fascism and Russia had a communist revolution. In his theory, democracy emerged when there was a strong, politically assertive, commercial middle class, and when agriculture had commercialized so that there were no feudal labor relations in the countryside. Fascism arose when the middle classes were weak and entered into a political coalition with landowners. Finally, a communist revolution resulted when the middle classes were non-existent, agriculture was not commercialized, and rural labor was repressed through feudal regulations." (AJR)

China then was in a similar social conditions with Russia. Although many ideas in the Marxism has very little common with the Chinese traditional philosophy, but its slogan of fighting for the social Justice and building the country owned by the people were strongly attractive to the poor peasants and some intellectual. So from the birth of the CCP it declared its mission as fighting for the people's interests. After took over the governing power from the National Party in 1949, its mission became governing for the people's interests.

In the China's long history, there were many civil wars fighting for the ruling power, but never had any civil wars based on ideology. Because the world was under the split ideological blocks after the WWII, the civil war of China in 1946-1949 was the only civil war in the China's history based on the opposite ideologies. Very naturally the winner side of the war also claimed the winning of the ideology and the eligibility of the ruling power has to be based on that ideology. So that is why PRC is a country has the party-state political structure and had a dominated communism ideology.

Since PRC established the message that CCP is the savior of the people and savior of the country has been constantly delivered to the public by the state owned media. Although by the definition of the Constitution, the people should be the owner of the state, in the real life, it has become the "common knowledge" that the interest of CCP, the interest of the nation, and the interest of people

are just one, and the opposite to the CCP is equivalent to opposite the nation and people. This kind of thinking did not change much even the after 30 years reform when China has been changed a lot in all prospects of life.

CCP, as the “holy” saver of the people and the country, has the unavoidable duty to provide the good life to the people. This is the permissions that CCP made to the people long time ago and the result of the Culture Revolution made this permission became so vague. To save the political eligibility could be the most strong motivation for the leaders in the later 1970 to strongly push for the reform.

The priority of that time was to produce the enough food, to boom the consumer market, and to solve the unemployment problems. Because there was less vested interested from the top leaders, so there was less interruption to the micro level operation. The change of the institutions was largely from the grass level’s experiential and then endorsed by the authority after they were successful.

The success of the early stage reform --- the improved living standard, the settled unemployed youth, the returned political trust from the public, the liberal and relaxed social atmosphere, was a political victory, rather the economic benefit for the leaders. This approved that the political power holder, even the monopoly power holder, some time supply the institutions may not for the economic benefit only. To strength the political ruling was also a very important motivation. This kind of the ruling power enhanced institutions supply could be benefit for the public if it is original from the public.

This format of the institutions supply largely reversed in the 1990s and forwards time. The later part of the reform “omniscience government” came to the front again. Much fewer institutions changes were from the grass level innovation, and the government, both Central and local, became the positive suppliers of the institutions.

The political motivation ---- enhance the ruling--- was still in top agenda, but the channel to enhance ruling was not longer to be the responding to the people’s demand. Most government leaded reform, such as SOEs selling off, financial markets, real estate markets, all generated huge amount economic rents, and the most of this economic rents were distributed to the government officials, both central and local, and their connections. This style institutions change can be best explained by the AJR’s social conflict model. According to the official statistic report China’s GINI ratio raised from 0.18 in 1978 to close 0.50 last years.

6. Culture roots and its influences

The long and rich culture tradition and the 20th century’s experience had the strong influenced in China’s current institutions choice. So to understand the institutions change of China must has some knowledge on the Chinese philosophical tradition.

China ---- this ancient "Central Kingdom" maintained her top position of the world for thousands years and enjoyed the splendid glorious in the most of time of human history. Durant expressed very high admiring to this eastern civilization: "altogether the most perfect type of humanity as a normal phenomenon has been elaborated in ancient China... China has created the highest universal culture of being hitherto known... The greatness of China takes hold of and impresses me more and more... The great men of this country stand on a higher level of culture than ours do;... these gentlemen... stand on an extraordinarily high level as types; especially their superiority impresses me.... How perfect the courtesy of the cultured China-man!... China's supremacy of form is unquestionable in all circumstances.... The China-man is perhaps the profoundest of all men." (W&A Durant) The Tong Dynasty (618-907) was described as : "China undoubtedly stood in the very forefront of civilization. She was then the most powerful, the most enlightened, the most progressive, and the best-governed empire on the face of the globe. It was the most polished epoch that the world had ever seen" (W&A Durant)

(1) Philosophies

Like any great civilization in the world the brilliant development performance in the history was the result of the intelligent and rational philosophies. The philosophical "enlightenment" for China was happened in the "Spring and Autumn" (770-475 B.C.) time. It was the time of "to let one hundred flowers blooms and let one hundred schools of thoughts contend". The mostly influential schools, include: Confucianism, Daoism, Fa Jia (law oriented), Bing jia (military oriented). These schools influenced Chinese people's thinking for thousands years.

From the "Spring and Autumn" time Chinese intellectual abandoned the theological superstitious and moved into the observation based rational reasons. Many philosophical concepts of the "Spring and Autumn" philosophies are very identical with the ancient Greece philosophies

Nature Law

<<Dao De Jing>> (translated as <<Tao Te Ching>> in others work) by Lao Zi (translated as Lao tzi or "Old Master in others work) is the earliest and the most comprehensive theoretical work about the Nature Law. It has been introduced to outside China at least since 16th century or even earlier. According to the UNESCO <<Dao De Jing>> is the 2nd widely distributed book globally after Bible.

"Man models himself after the earth;
The earth models itself after heaven;
The heaven models itself after Tao;
Tao models itself after nature;"

"Dao is the source of virtue....although Dao is the primary principle that pervades heaven (i.e. the sky) and Earth, it is more like nature unpersonfied than a divine person. Dao generates and regenerates spontaneously in a natural way and does not rely on motives and sources. Think of the ultimate, multifarious powers of nature, join those contradictory or complementary power (yin/yang) into ONE, and you are close to thinking of the Dao". (Calrk and Liu)

"Perhaps we shall burn every book but one behind us, and find a summary of wisdom in the Tao-Te-Ching." (W&A Durant)

Epistemology

"Spring and Autumn " philosophies emphasized that the knowledge come from the observation experimental activities. The right attitude of learning should be "格物致知" ----- knowing the root of things to achieve the true knowledge. ("Big Study")

At the very early stage of the civilization time Chinese created the letters of their language by the observation on the nature. This was the starting of the empirical based Chinese's Epistemology

Relativity

Chinese has know the opposition things are existing in the harmony way for the long time. The concepts of Yin and Yang, was firstly raised by the Fu Xi 10000 years ago, now are known by all of the world.

<<Dao De Jing>> further developed the idea of relativity

“therefore

Being and non-being interdependent in growth;

Difficult and easy interdependent in completion;

Long and short interdependent in contrast;

High and low interdependent in position;

Tones and voice interdependent in harmony;

Front and behind interdependent in company”

“To yield is to be persevered whole.

To be bent is to become straight.

To be hollow is to be filled.

To be tattered is to be renewed.

To be in wants is to possess.

To have plenty is to be confused’

Relativity teaches Chinese people do not look the thing in the absolute manner, bad, wrong, failure, if looks from another side, there could be some positive attributes. At the same time, when have the good, right, success, should also aware there could be the possibility to tune another way around. That was why the well educated classical Chinese “gentry” could maintain the characters of never being arrogant also never being inferiority in all circumstances. Relativity helped Chinese people to build many wisdom of the life, such as central harmony (中庸), avoid extremeness, balance the difference forces.

Nature of The Nation:

The pure dictatorship, that is monopolizing the power for the self interesting, had never been morally accepted in the thousand years history. The moral role model were the Emperor Yao and Emperor Shun who were received ruling power by the merits, not by the heritage. Although in

later years the heritage ruling power transferring became the routine, but this ruling power was never became the absolute one. "Spring and Autumn " philosophers believed that the ruling class can be supported by people, also can be overthrow by people. Only those who can win the people's heart then win the ruling right.

"The people are the actual and proper source of political sovereignty, for any government that does not retain their confidence sooner or later falls." "The first principle of government, in the view of Confucius, is as the first principle of character- sincerity. Therefore the prime instrument of government is good example: the ruler must be an eminence of model behavior, from which, by prestige imitation, right conduct will pour down upon his people." (W.&A. Durant)

(2) Political Governing Philosophies

There are two major political philosophies in Chinese history, one is Daoist, another is Confucianism.

Daoist ----- less governing is a better governing

DAOist believes that the less governance is a better governance (无为而治). Dao theory is very close to modern democracy concept, that is let the people to manage themselves.

“as for him who is highest
the people just know he is there
his deputy's cherished and praised
of the third. they are frightened
the forth, they despise and revile
if you trust people less than enough
some of them never trust you”

“As I refrain, the people will reform;
since I like quiet, they will keep order;
when I forebear, the people will prosper;
when I want nothing, they will be honest”

“Listlessly govern
Happy your people
Govern exactingly
Restless your people”

Confucianism ----- parenthood love by benevolent rulers

Confucius believed that the country should be ruled by the well educated self-disciplined elites. These elite rulers must use this power for the interest of public, not for themselves. If they do not, people then have the right to push them out of the power.

Confucius had a full self-enlightens system to train the ruling elites and the eligibility of the ruling system was mainly support by the high moral standards of the ruler and the ruling team rather by the rule of the law.

The literati gentry class, “士”, had an unique social, political, and culture status that cannot be found in may other historical civilization. This literati class essentially ruled China during the much of the history. The personality they should possess is “wealth and fame never mean much to him, poverty and obscurity never sway him, and imposing forces never awe him” (Coase & Wang)

(3) Economic thoughts

“Historically, China has always been a land of commerce and private entrepreneurship” (Coase & Wang) The commercial activity was started very early in China, and in thousands years history of the ancient China never happened the anti-commerce kind of thought, like it was happened in the Europe during the medieval time and 20th century in the Communist countries. However, the attitude to the wealth, under the traditional Chinese philosophy, is a neutral one, like everything else. People has the right to gain the wealth through the work and trade, but the commercial activities must follow the principle of “yi”, (Justice), i.e. the game of the wealth should be fair and honest.

The commercial morality was required not only for the individual business person, but for the nation as well. “A nation should not take the high material wealth as its goal, but the rightness.” (Big Study) The powerful emperor was some time regulated the economy for the purpose of justice. The early years of Han Dynasty (200 -100 B. C.) the emperor Wen Di and Jing Di adopted the Daoist philosophy: better governing is the less governing, provided very liberal environment for the commercial activities. The economy boomed very fast and some business people accumulated the large amount of wealth. Some local government, actually were all from relatives of the royal family, merged the desire to take over the central power. Emperor Han Wu, in the name of social justice, did the first time socialism revolution in the China’s history. He regulated the major business, such as the salt sales and ironing production, and made these business became the state monopoly, he also set the high tax rate for the large business. This ancient time free market economy was by then largely destroyed.

So although China never had any anti-commerce thought, but the Calvert style logic---- “more wealth, more god’s love” --- also did not happened in China. The commercial operation, market trading, international trade were appeared at very early stage of the history, but the merchant class never win the social respect and never win the independent political power, even some merchants did own the large amount of wealth. Some scholars stated the reason for China did not developed capitalism was because the property protection legal system was never established in China. But the moral based philosophical thinking towards to commerce activity cold also be a important reason. .

(4) Rule of the law

“Law is the authoritative principle of the people and is the basis of government; it is what shapes the people. Trying to govern while eliminating the law is like a desire not to be hungry while eliminating food, or a desire not to be cold while eliminating clothes, or a desire to go east while one moves west. It is clear enough that there is no hope of realizing it.”

----- 商君书- Book of Emperor Shang, (16th -11th century B.C.)

The concepts of the nature laws and the relations between the nature law and human law were well addressed in the "Spring and Autumn" philosophies, such as the works of Laozi, Meng zi, and Huang Lao Philosophy. In this sense, China and the western world have the same philosophical root of the concepts of the rule of law.

Emperor Qin Shi Huang, who united China from six small states, adopted Fa jia, (law oriented) as the ruling philosophy. However, because Qin Shi Huang's rule of the law was over harsh, the new united kingdom only lasted two generations. So the later emperors became very caution to use the Fa jia philosophy, at least, did not openly claim for it.

The next new kingdom was the great Han dynasty (206 B.C. --- 220 A. D.) which last for about 400 years. Learned from the lesson of the collapse of Qin, the early emperors of Han dynasty adopted the Daoist thought and implemented the very liberal political and economic policies. The free markets economy developed to the very mature stage, even reached to the ideal status described by the Amdam Smith ----the general equilibrium, i.e. all industrial had the same average profit margin. However, the Emperor Han Wu, the fourth generation of the Han emperors, under the threaten of the localism and the border unrest, followed the advised of Confucianism scholar Dong Zhong Shu, made that the Confucianism as the sole official philosophy. Confucianism, emphasize the hierarchy and loyalty, was so suitable for the need for that time political conditions. Since then the influences of others philosophic schools in China's political polices were largely reduced.

Confucianism took all aspects of human life as the results of moral senses. Law, excused by the external forces, was less effective and less humanity than to invoke the internal consciousness. All people, regardless which social class was coming from, can behavior like the "sage" as long as receive the enough the Confucianism school education.

"Historically, China had been heavily influenced by Confucianism. The educated elite occupied a central and privileged status. As interpreters and messengers of Confucianism, they played a critical role in legitimizing political order and maintaining the moral compass in society. As the civil servants, they directly exercised political power in the imperial court, representing an instructional counterbalance to the royal power of the emperor. In addition, they stood as the core of what was called "gentry class" which provided local public goods and maintained social order at the sub-county level, beyond the reach of centralized imperial power."(Coase & Wang)

If the purpose of the institutions was for providing the common rules and reduced the uncertainty, then Confucianism value, in some degree, achieved this purpose. As the commonly accepted behavior standards, it built a kind of trust between the "gentry class", or the educated people who are the major participants of commercial activities and the civil services systems. The ancient China was more based on the moral and value to limited the uncertainty on all social activities.

(5) A Design for the Central Kingdom

Zhou li₂ (translated as Chou li before), was a work of later Zhou Dynasty (11th century -771

B.C.) is the earliest full design of the governing institutions. Its formation should be earlier than the <<Dao Ge Jing>> and Confucius work. Because both <<Dao Ge Jing>> and Confucius work were not conceptually fresh starts, they were the heritage of the previous intellectual's work. So the principles in Zhou Li were closely related with Confucianism.

Zhou Li covered all aspects of governing a nation, it includes:

The architecture design for the kingdom, city, and palace.

The landscape characters of the old capital, such as Xi An, Luo Yang, and Beijing are all followed the principles defined by the Zhou Li

The land systems and the ownership distributions

Ancient China was an agriculture country and the land was so important for either the prosperity and the stability. Zhou Li offered a very rational and fair design of how to split and distribute the land according to the need and the ability and how to collect tax based on the land ownership.

Six law sets

- Governing laws: the rules for how to manage the governing team. What were the duties and responsibility of each department, how officials' performance were assessed and compensated, how wrong doings been punished, and how the operating records been kept. It is very interesting that Zhou Li already mentioned how and why to set up the check and balance system between the different government departments. In Tang Dynasty, this idea was well implemented. There were different departments to design the policies, verify and examine the policies, and execute the policies.
- Cultivation laws: the rules to help people to cultivate their characters and personalities so that the harmony relations between the people can be maintained. Zhou Li designed a national wide education system and this education was not only for the children but for the adults as well. Everyone in the society must understand the good moral, good manner, and good sense of responsibility.
- Ceremony laws: the rules for memorial ceremony to the heaven, to the ancestors, and others. It also includes the rules of social orders.
- Administration laws: for managing the local governments and building the infrastructure
- Criminal laws: the rules for punishing the criminal behaviors.
- Economic affairs laws: included the laws on fiscal management, such as the tax rate and tax collections. It also includes the market management rules. The market selling activities and the contracts were promised but the necessary government interruptions were allowed and only purpose of these interruptions was for protecting the interests of the consumers. The false goods must be punished and the conflicting on the contracts must be solved locally in a certain time.

Zhou Li is a earliest designed institutions but many of its rules are still the modern world practice.

"Chou-li, or Law of Chou, set for two thousand years the Chinese conception of government: an emperor ruling as the vicar and "Son of Heaven," and holding power through the possession of virtue and piety; an aristocracy, partly of birth and partly of training, administering the offices of the state; a people dutifully tilling the soil, living in patriarchal families, enjoying civil rights but having no voice in public affairs; and a cabinet of six ministries controlling respectively the life and activities of the emperor, the welfare and early marriage of the people, the ceremonies and divination of religion, the preparation and prosecution of war, the administration of justice, and the organization of public works. It is an almost ideal code." (W&A Durant)

Zhou Li, a set of basic guild for the ancient kingdom institutions design, even thousands years later the Ming and Qing Dynasty still follow the most administration system designed in Zhou Li

2. Alienation of the civilization

"Spring and Autumn " philosophies developed full set wise knowledge of the human society and the ancient Chinese society was built according to the "Spring and Autumn " philosophies did contents many rational elements even in the modern eyes.

The declining of such great civilization in the later 19th and early 20th puzzled many historians. Durants showed the great sympathy on the decline of such great civilization:"it was admirable that a society should make the experiment of being ruled, socially and politically, by men rained in philosophy and the humanities. It was an act of high tragedy when that system, and the entire civilization of which it formed the guiding part, were struck down and destroyed by the inexorable forces of evolution and history." (W&A Durant)

They pointed out that beside the invading from the western countries, there were some internal reasons:"...(Confucianism) that philosophy could not be a complete nourishment in itself. It was well fitted to a nation struggling out of chaos and weakness into order and strength, but it would prove a shackle upon a country compelled by international competition to change and grow. " (W&A Durant)

In the most part of the history, China was stayed along without much competitive challenge, and also because this, the fundamentals of this civilization was never be questioned and attacked. Western world, was totally another story. For thousands years, wars were always going on for competing the religions, territory, resources, and later for the colonies. This experiences generated the most basic and also the most significant culture: competition.

Since the middle 19th century, drove by the mechanism and the competition between the nations, Europe countries came to Asia for more trading opportunities. As the largest market in the eastern world, China very maturely became the target of these hunters. Already experienced some hundred years stagnate, China, at the late of Qing dynasty, was at a very fragile condition, so it is not surprise, China lost several wars with the western countries and with Japan

7. History influence in the institutions choices

Path dependent theory tells us that the past institutions choice influence the future institutions choices. China's reform demonstrated as a clear example of the path dependent phenomena, both her own traditions and her 20's century experiences have the strong influences on the current institutions choices

(1) Philosophy

The reform was the unavoidable choice after the culture revolution, but how to reform and the choice on the reform's policies were determined by the political philosophy. The choices that Chinese leaders made in later 1970's, ---- from the absolute and dogmatic truth to the relative and empirical truth determined the destiny of the reform, at least was the finally explain of the early stage success of the reform. Although the economic achievements of the reform was always be plausible, but the most fundamental reasons for the reform performance is not an economic one, but a philosophy one.

The thought of the relative and empirical truth has been existed in China for the long time. "*Seek Truth From Fact*" was a old Chinese saying 2000 years ago. It was originally from the <<Book of Han>>. Later Mao used it as his teaching since 1940's. In the CCP long history the rigid Stalin style dogmatism and the practical empiricism were always co-existing and always fighting for the leadership and the revolution approaches. Culture Revolution was not only the worse time economically but also the worst time philosophically and culturally. In the several thousand years history there was never had such mass killing and mass insulting simply based on the different in ideologies, Confucianism, Daoist, and Buddhism all took open mind attitude to the different ideologies and believing.

Since the middle 19th century China experienced one and half century's anti-traditions movement. "Its radical anti-traditionalism and extreme examples of culture self-negation and self-destruction ---which amounted to nothing less than total de-Sinification---were probably unprecedented in human history." (Coase & Wang) The traditional Confucianism, Daoist, and Buddhism were totally disappeared in the official culture heritage channel, such as the school's text books, the media, and all publications. However, the power for the culture tradition was the extremely strong. It is still existing a lot in people's daily life, in customs, in folks songs, and in the language. The first generation CCP leaders, who took the revolution as their life mission even when there was many other possible choices for their life, were very spiritual people. They were the mixed of Confucianism "shi", who believed that they have the nature respectability for the strong nation and the well being of their people; the genuine priests, who believed that others only can be saved by their missions; and the communist soldiers, who took their idealism above their own life as well as others life. This spiritual mixture was the results of the mutual influences from the traditions and outsider ideologies, and it is also the reason of the mutual styles political behaves. They could took the pragmatic approach to reform, they also could took the extreme approach to kill any attempts of challenging to the ruling power.

China's 30 years reform marked the beginning of the journey to return to the historical normal condition ----- a rational secular society. The journey is still has a long way to go, as the

philosophical faults of the Culture Revolution has not been well understood by a lot of people. That was the why until a few years ago there were still someone missed out the Culture Revolution!

The current institutions choice was not just influenced by the history. Since China opened her door to the world, many different philosophies were introduced to China, such as the liberalism, individualism, hedonism, money worship, etc, they are also have some degree impact on the institutions choices. However, these new thoughts have not become the dominated philosophy yet and the future direction of China's development depends on how Chinese people to choice their value set from all different resources, include their own traditions and the knowledge from outside.

(2) Political system

The Chinese reform experience, the successful economic reform without the significant political reform, had puzzled many researchers. Without the check and balanced political power structure and the independent legal system how to control the expropriation from the authority? And how the investors maintain the confidence ?

The assumptions made by the western institutional research scholars is that “the holders of the political power cannot make the commitment not to use the power for their own interest”. This the well-known AJR's “ commitment problems”.

This commitment problem does actually exist in China, but does not exist in the formal and informal ideology. According to the traditional political ideology the ruling class must be the benevolence. As long as people obey to the ruler the social well being can be achieved. Since 20'th century CCP used “serving the people” as their core mission from the very beginning of its life, and after took over the ruling the very powerful state-owned propaganda always deliver this message to the public, even during the Culture Revolution, people was told the class struggle was also good for the people's future! So different with the western society where people always has the suspicious to the power holders, the Chinese traditions as well as the CCP's propaganda always tell Chinese people the power holder is a source of parental love.

In ancient China the political power structure was a centralized power with some check and balanced mechanism and the “nature justice” as the ultimate judgment. There was no horizontal diversification of the power, i.e. there was no counter party to share the ruling power. Emperor and his power was constrained by the moral term: if the emperor cannot serve the people well, people has the right to overthrow him. There was the check and balance system in the administration: Neishi(内史) : draft the policy, Meisia (门下) :exam the purposed policy and if the policy was approved, then give the emperor to sign and become the law; but this department also had the power to reject it; Zhang shu (中书), execute the law. Jian guan(谏官), was responsible for making the suggestion and criticize the emperor's decisions, “ The censor was head of a board whose function it was to inspect all officials in the administration of their duty; and the emperor was not exempt from this supervision. Several time in the history the censor has reproved the emperor himself.” (W&A Durant)

There ruling class did open to the general public through the public exam with it the ordinary people could be able to enter the ruling class by passing the exam. Public exam was the only way to maintain the mobilizing the social classes.

Durants gave the high commends on this civil service examine selection system: "the merits of the system were abundant. Here were no manipulated nominations, no vulgar campaigns of misrepresentation and hypocrisy, no sham battles of twin parties, no noisy or corrupt elections, no ascent to office through a meretricious popularity. It was a democracy in the best sense of the term, as equality of opportunity for all in the competition for leadership and place; and it was an aristocracy in its finest form, as a government by the ablest men, democratically elected from every rank in every generation. By this system the national mind and ambition were turned in the direction of study, and the national heroes and models were men of culture rather than masters of wealth." (W&A Durant)

Many characters of today's political system still reflect the influence of the tradition. For example, the benevolent political philosophy, the centralized power structure, the examination system to select public services. But there were a few significant differences between the today's political system and the traditional one

1). The ancient China's emperors all claimed they were the Confucianism, but no of them "own" the Confucianism, i.e. the ruling ideology was independent from the ruling power. When emperor's behavior did not meet the principle of the Confusions, people, according to the "ruling ideology", could depose the emperors. Although this self-correction system was very slow and not effective most time, at least, there was a one external constrains existing.

By the contrary, CCP "holiness" of the ruling power comes from the "holiness" of the ruling ideology. So there is not any external constraint for the ruling power. The only correction mechanism is the internal examine, such as anti-corruption campaigns and all kind of "education campaigns.

2) The ancient China political power was only down to the level of county, below that was actually the self-governed by the local "gentry class". This gentry class generally was the well educated Confucians and did not necessary unconditionally loyalty to the emperors, rather they were loyalty to the nature justice. If the emperors did not follow the "Dao", or nature law (nature justice), they would not loyalty to the emperors any more. In the history, many ruling power's change over were because the emperors bad ruling performance and the most rebels were from the countryside. There is a old Chinese saying "people like water, can support the (ruling) boats, also can turn it upside down".

But CCP, started from the grassroots level, had the organizational net work down to the every village of China. So through this net work, CCP could maintain the administrative loyalty from the every corner of the country. The external power threaten is not existing under the CCP political structure. Any wrong doings and mistakes are only can be corrected by the internal conscious.

These characters of CCP, of course, are from the 20's century experiences.

(3) Economic and legal institutions

According to the AJR, the choice on the economic institutions are the nature result of the choice on the political institutions and the distribution of the political rights determines the distribution of the economic right. As the discussion on the section 4, this theory does not very match with the China's early stage reform, by then the economic benefit did distributed to the grassroots level even under the centralized political power, the reason of AJR theory invalid to the this stage reform was because it missed out the political motivation in the institutions choices.

However, this theory is perfectly suitable for the later part of the reform. Leaders of the later time may not be that ideological anymore and became more "economic rational". The political goal is still "in power for long time", but to achieve this goal was no long through the pleasing to the public, rather through holding the control position in the "market economy." The American political joking "in politics, first is money, second is money, third is still money" was wildly spread in the Chinese politicians and may largely changed the understanding on the nature of the political power.

Legal institutions are the part of the political institutions so that possess the same characters. The most fatal problem of the Chinese legal system is the administrative interruption on the legislation and judicial systems. "An important feature of the Chinese judicial system that works against unity and consistent enforcement is the dependence of courts on local government. The power of appointment and dismissal of a court's leadership rests formally with the People's Congress at the same administrative level; in practice, it is in the hands of the local Communist Party organizational department. Local governments also control court finances, material supplies, and other welfare benefits for court officials and their families. Thus, it is very difficult for courts to go against the wishes of local government even should they wish to do so" (Clarke, Murrell, Whiting). So the low efficiency of the legal system also came from the political structure.

8. Conclusion

The unique China's reform experience provided a very sought after raw material for the institutional theory research. The paper concentrates on what are the unique feathers of China's reform and the reasons behind these unique feathers. A few important lesson could drew from the China's experience which should be inspiring for he further institutions study:

1. Political motivation does existing in the institutions choices. The institutions choice is not only influenced by the economic rent motivation, also influenced by the political goal and mission.
2. Ideology does matter for the institutions change. Chinese experience is a strong empirical example for ideology does matter. So the economic institutions, political institutions, and ideology should be formed in one analysis framework.
3. Ideology's influence should be a dynamic concepts. It include the past knowledge, also include the continually learned new knowledge. Institutions and ideology are mutually

supported.

4. The endogenous change and the enforced change are often mixed together. The format of the institutions change, i.e. how much are endogenous and how much are enforced, influenced by the ideology and political power structure. The economic power is not necessary can be converted to the political power, depends on the prevailing political power structure and political philosophy.
5. Path dependent theory is also approved by the China's 30 years reform experience. However, both political structure's influence and traditional culture's influence are currently insufficient studied. The final explanation of China's unique institutions change could be very possible from her unusual past experience. Japan, Korea, and Taiwan who share the same Confucianism tradition with China, but they did not have the Communism experience. Other previous Communist countries who do not have Confucianism tradition.

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Table -1

	non state ownership		non state ownership
1978	0.2237	1993	0.5305
1979	0.2153	1994	0.6266
1980	0.2403	1995	0.6603
1981	0.2524	1996	0.6368
1982	0.2556	1997	0.6838
1983	0.2665	1998	0.7717
1984	0.3091	1999	0.8052
1985	0.3514	2000	0.8175
1986	0.3772	2001	0.8399
1987	0.4027	2002	0.8546
1988	0.432	2003	0.8534
1989	0.4394	2004	0.8356
1990	0.4539	2005	0.8336
1991	0.4383	2006	0.8334
1992	0.4848		

Data source : (Kong ling kuan)

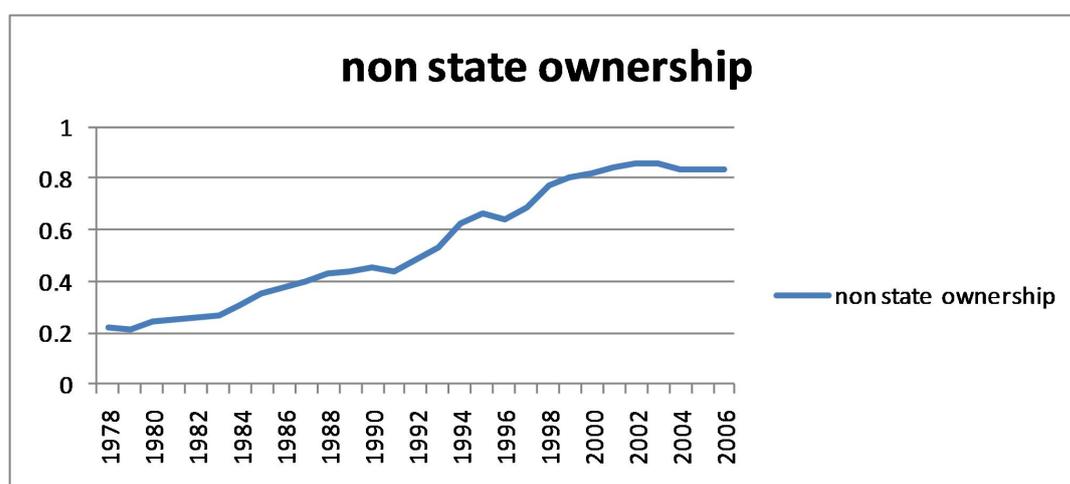


Table -2

consumer products

	state	guide	market		state	guide	market
1978	97	0	3	1991	20.9	10.3	68.8
1979	89.85	0.61	9.54	1992	5.9	1.1	93
1980	82.59	3.79	13.62	1993	4.8	1.4	93.8
1981	75.32	6.98	17.7	1994	7.2	2.4	90.4
1982	68.06	10.17	21.77	1995	8.8	2.4	88.8
1983	60.79	13.36	25.85	1996	6.3	1.2	92.5
1984	53.53	16.55	29.93	1997	5.5	1.3	93.2
1985	47	19	34	1998	4.1	1.2	94.7
1986	35	25	40	1999	3.7	1.5	91.8
1987	33.7	28	38.3	2000	3.2	1	95.8
1988	28.9	21.8	49.3	2001	2.7	1.3	96
1989	31.3	23.2	45.5	2002	2.6	1.3	96.1
1990	29.8	17.2	53	2003	3	1.4	95.6

Data source: (Kang ji jiu)

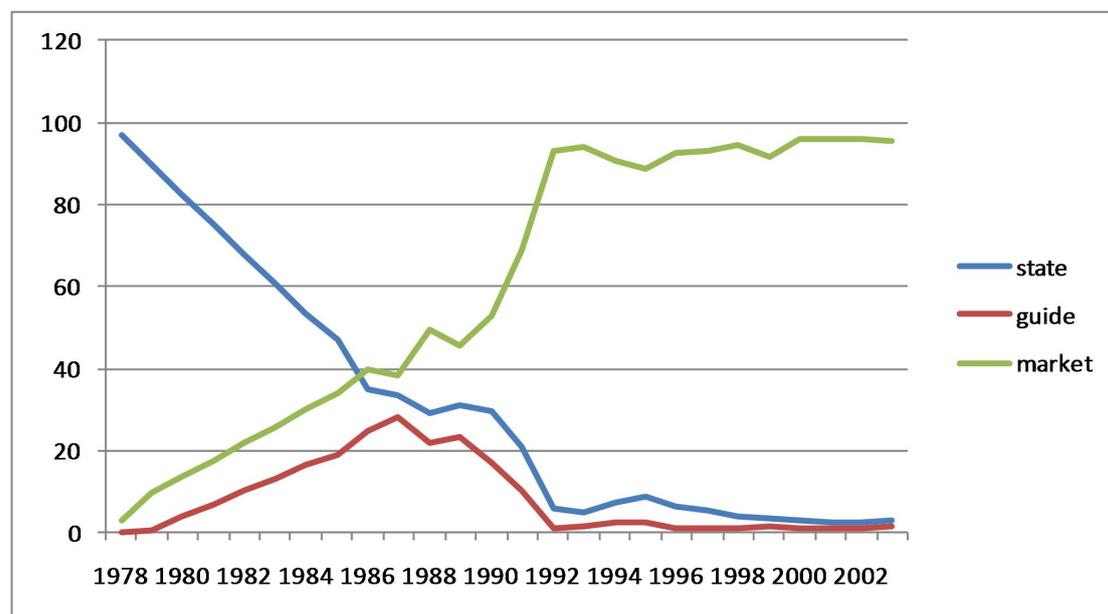


Table 3

production material market

	state	guide	market		state	guide	market
1978	100	0	0	1991	36	18.3	45.7
1979	92.79	5.42	1.78	1992	18.7	7.5	73.8
1980	88.86	8.77	2.37	1993	13.8	5.1	81.1
1981	84.86	8.77	2.37	1994	14.7	5.3	80
1982	81	14.87	4.12	1995	15.6	6.5	77.9
1983	77.07	17.5	5.43	1996	14	4.9	81.1
1984	73.14	19.72	7.14	1997	13.6	4.8	81.6
1985	69.21	21.41	9.38	1998	9.6	4.4	86
1986	65.28	22.41	12.31	1999	9.6	4.8	85.6
1987	61.35	22.5	16.16	2000	8.4	4.2	87.4
1988	57.42	21.4	21.18	2001	9.5	2.9	87.6
1989	53.49	18.74	27.77	2002	9.7	3	87.3
1990	44.6	19	36.4	2003	9.9	2.7	87.4

Data source: (Kang ji jiu)

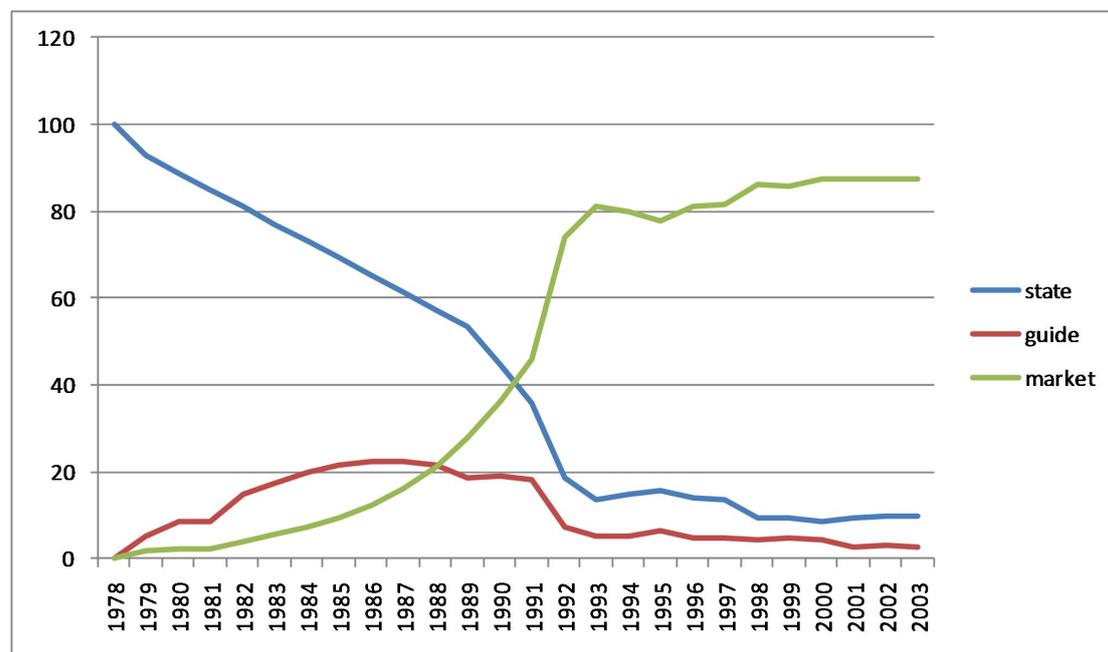


Table -4

agriculture products market

	state	guide	market		state	guide	market
1978	92.6	1.8	5.6	1991	22.2	20	57.8
1979	88.4	4.9	6.7	1992	12.5	5.7	81.8
1980	82.3	9.5	8.2	1993	10.4	2.1	87.5
1981	79.1	11.5	9.4	1994	16.6	4.1	79.3
1982	78.3	11.5	9.4	1995	17	4.4	78.6
1983	76.1	13.4	10.5	1996	16.9	4.1	79
1984	67.5	14.4	18.1	1997	16.1	3.4	80.5
1985	37	23	40	1998	9.1	7.1	83.8
1986	35.3	21	43.7	1999	6.7	2.9	90.4
1987	29.4	16.8	53.8	2000	4.7	2.8	92.5
1988	24	19	57	2001	2.7	3.4	93.9
1989	35.3	24.3	40.4	2002	2.6	2.9	94.5
1990	25	23.4	51.6	2003	1.9	1.6	96.5

Data source: (Kang ji jiu)

