

## **SOCIALIST MARKET ECONOMY**

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### *Abstract*

*The term socialist market economy indicates the Chinese economic structure, characterized by a mixed system presenting the typical features both of market and planning economies. In this type of system, the political authoritarianism, due to the 1949 socialist regime, matches with a market economy developed by the reform process of the eighties. The similarity can be especially identified in the gradualism with which China has started restructuring a Marxist economic kind of system according to the market rules. This gradualism has undoubtedly been an essential factor in order to achieve any kind of success as a consequence of these reforms, but it has also caused some instability factors. For instance, it has created a system in which private and public companies, market prices and planning prices, protection of private property and communist ideology, competition and state intervention, simultaneously coexist.*

The term "socialist market economy" was used for the first time in 1992, during the XIV Congress of the Chinese Communist Party to outline the new goals of the economic reforms.

This concept was institutionalized by the introduction of constitutional changes and so, the socialist market economy became the official term to define the current Chinese economic and social system.

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China's economy can be considered as a closed and planned one, inspired by the Soviet model of development<sup>2</sup>: starting from the Chinese Communist revolution in 1949 until the Maoist era<sup>3</sup> and up to 1978.

The birth of the socialist market economy, which dated back since the modernization processes in 1978, represented a breakthrough for the Maoist period, in the changing international background of the seventies and of the eighties which testified the failure of Soviet Communists regimes. The integration of developing countries into the world economy, forced the CCP to start seeking for a national path which would have led to socialism.

Since the eighties, although the firm intention to maintain a socialist economic system, it was launched a program of structural reforms that generated a gradual abandonment of the Marxist planned system. In the following twenty years, China would have undertaken radical changes in the economic system.

The structural reforms, started in 1978, did not directly lead to a capitalist and market economy, but eventually to a mixed system that kept being characterized by an autonomy from the market that continuously collided with the omnipresence of the bureaucracy of the Party, in all of the territorial aspects.

This also led to a "double face" of the Country: the first one was characterized by a Party-State with the role of manager and controller of the economic life; while the second one was represented by the social economic changes that occurred over time, and which could be considered as an expression of a more and more dynamic society as a direct consequence of these reforms.

The Chinese socialist market economy overcame the dichotomous schema of mere juxtaposition (aut ...aut) between socialism and capitalism by reaching an approach which could be compatible with both. In the institutional framework of a communist regime, this kind of compatibility took place, at the very beginning, only in certain ar-

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<sup>2</sup> Model based on central planning and allocation of administrative resources.

<sup>3</sup> Mao Tse-tung's CCP leadership (1943-1976).

eas, like trade and services, but afterwards, in an ever more widespread way, in the development focused on prices, markets, businesses and profits. These are the basic elements for the existence of a market economy. The promulgation of the "Law on industrial property of the people" in 1988, can be considered as a case in point. In fact, it adjusted the model of **corporate governance** of Chinese enterprises to the standards of the Western market economy by binding them to the achievement of the capitalist profit "but also" to the satisfaction of the socialist planning duties.

Elements of different ideological nature merged in the term socialist market economy, prima facie contradictory, by forcing the hammer and sickle symbol to walk hand in hand with the surplus value, profit and financial returns.

Another aspect of the compatibility between the market logic and the Marxist ideology concerns the distribution of wealth. In fact, this concept has occupied a key role in the economic theory since the nineteenth century. In literature, a closed and planned economy, tends to have a more egalitarian distribution of wealth; on the contrary, in an open and liberal economy the effects of the market distort such distribution.

The Chinese case is emblematic. As a nation that declares itself as a Communist one, it has the highest income inequality of the world. As a matter of fact, in 2010, the Gini index amounted to 0.61 upwards of the world average level of 0.44.

These elements, along with the institutionalization of private property protection in a socialist system, the presence of both public and private companies together with the price system "dual track"- that managed to merge capitalist matrix elements (**market prices**) with others of socialist nature (planned prices) - represent some of the peculiarities of the socialist market economy.

This kind of economic policy strategies, in the Chinese developmental model, exhibits many similarities but also many aspects that deviate from the traditional econom-

ic and political strategies of the liberal States as well as from those characterized by a "Developmental" State.

The aspects that distinguish the socialist market economy can be found in pragmatism, gradualism, in the authority of the state intervention in the economy and in the market needs, which take priority over the creation of a democratic system. Besides, for this reason, it is not possible to regard China just as a Country in transition, because considering all of the former socialist economies, China's economic modernization is not characterized by any kind of institutional modernization<sup>4</sup>, in contrast with the Western model, which requires a free market system combined with a liberal democratic one.

The Chinese institutions repeat some of the successful factors typical of a system in an open economy, such as the adaptation of the system of market prices, the acquisition of corporate governance models of enterprises, exports and receiving of foreign investments. However, these institutions also adapt and safeguard the socialist ideology in favor of the legitimacy of the CCP, finding a meeting point between economic growth and political stability.

The new Chinese ruling class understands that just a part of the western modernity can be considered useful, since it guarantees to the authoritarian regime the possibility to gain legitimacy and consensus to be effectively used in the markets to create wealth.

The State is in China the main "helmsman" that leads the country straight towards the economic modernization, in a historical period in which it is losing its role as the main actor in the international system. The integration into the world economy has been carried out thanks to the initiative of the Chinese party-state and under its control, mainly by denying the neoclassical paradigm which states that it is hard to assert that deviations from the perfect market model may be beneficial in the long run, for any economic system.

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<sup>4</sup> The institutional framework is defined by the Chinese constitution "people's democratic dictatorship"

The current China's political-economic structure is a mixed system in which, in addition to the growing position reserved for the market and the role played by the authorities at the national level, keeps being present and relevant, especially locally speaking.

*Major economic reforms of the new developmental model*

The choices of economic policy adopted in China since 1978, have contributed to change the Maoist socialist model introducing a gradual restructuring of the traditional planned economic system about the market rules.

This gradual process invests mainly the sector of state-owned enterprises, the agricultural sector, banking, foreign markets and devolution.

In the public enterprises sector, the compatibility of private initiative with socialist ideals has been recognized at a constitutional level, paving the way to a system of non-state firms devoted to profit maximization and no longer characterized by a soft budget constraint,<sup>5</sup> exonerating administrators from any kind of responsibility. The general policy in this field has gradually reduced the weight of public enterprises, by allowing the private or collective companies to quickly increase their market share.

In the agricultural sector, communes<sup>6</sup> have been gradually abolished since 1978, proceeding to the redistribution of lands, which up to that moment, were totally owned by the State and finally creating a family responsibility system. These agricultural reforms represented a great incentive for peasantry, who could finally benefit from land concession as well as from the possibility to privately sell part of the agricultural production directly on the market. The liberalization of rural markets has led

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<sup>5</sup> Kornai (1979) defines soft budget constraint the typical situation of socialist economies, in which the State participates to cover the excess of expenses over the incomes of public enterprises.

<sup>6</sup> Basic structures of Chinese society established in the Country in 1958 because of the initiative of Mao Tse-tung. They were mostly based on the collective ownership of lands, where they used to carry out mainly agricultural activities.

to a partial abandonment of the old prices system, which had to coexist with different system of market prices, the so-called "dual track" system.

In 1983, the "dual track" also became a two-tier banking system. China separated the Central Bank (People's Bank of China) from the second-tier banks. The Central Bank has been entrusted exclusively with macroeconomics tasks, while the second-tier banks are: the Agricultural Bank, the Industrial and Commercial Bank, the Bank of China and Construction Bank. These are the four main public banks that are allowed to compete in different sectors since 1986. As a result of these reforms, the banking system has become the primary channel to achieve funding for investment, since the modernization process significantly reduces the ability of the state budget to mobilize and allocate resources.

However, in the foreign markets sector, the opening takes place under the pressure of international exports and through the establishment of Special Economic Zones<sup>7</sup> for the import of capitalist models and foreign direct investments. The exports have become one of the main causes of China's growth, spreading the competitiveness of exported products from intensive work sectors, to the ones with an higher degree of specialization, such as electronics. The Chinese economy shifted from being mostly a "factory of the world"<sup>8</sup> towards occupying the brand-new role of exporter of High Tech.

Furthermore, in the eighties, it took place a transition from an highly centralized economy, to a more decentralized one, in which the local politicians of the main cities of each province, as well as private and foreign operators, had a considerable action-taking faculty. The businesses and local administrative authorities established the profits to be realized, and also the state contributions. Not only did not this administrative decentralization limit the strong public power on the economic process-

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<sup>7</sup> Special Economic Zones were created in order to attract foreign investments and located in the eastern part of the country.

<sup>8</sup> China is often defined as the "factory of the world" especially in regard to some sectors, such as toys or textiles and clothing; the local manufacturing ability merge with the foreign technology, creating products at more favorable prices than in the Western markets.

es based on the programming of the central state, but also on those based on the control of local political authorities, such as provinces, cities and villages. At the end of the eighties, the majority of the public enterprises were under the direct control of local authorities. In China, therefore, everything is now formalized with a dual government system of the Country at peripheral, central, local and national level. Therefore, there is not a real separation between the State and the Party.

*Private ownership and socialist economy. Legal adjustment to market needs*

The characteristics of the new Chinese model of development emphasize the importance of private economic initiative carried out through the institution of private ownership which is generally considered the fundamental basis of two contrasting market representations: capitalism and socialism. The first emphasizes the sacredness of private ownership in opposition to the public good, while the second aims to its total abolition.

The institution of property right is the cornerstone of the main changes in the Chinese economic system as it represents the link between a planned economy and the choice of a socialist market one.

In 1982, thirty years after the Communist revolution of 1949, the Constitution incorporated into its system, the fundamental principles regarding the economy and the property system. The Articles 10, 11, 13 and 15 of the constitution were gradually modified, introducing, for the first time ever, the strengthening of each kind of promotion and protection of private enterprise, the right transfer to exploit the lands. The State was also entrusted with the task of carrying out a system based on the socialist market economy.

The existence of private enterprises and their development were finally recognized to be accessory to the socialist public economy. Property rights were also protected.

The presupposition of this constitutional adjustment process lies in China's interest to facilitate, even through legal instruments, the transition from a centrally planned economy to a socialist market one. With Articles 11, 12, 13 and 15 of the Chinese Constitution, it was introduced for the very first time, the concept of private property, which used to be considered as a dangerous institution for the consolidation of the socialist ideology, becoming the most obvious example of a "mixed" system defined, by the Chinese constitution, as a socialist market economy.

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