1. Who is in charge of the economy of the mainland? What are the ministries and organizations that are responsible for making major economic policies?

2. What ministries and organizations are responsible for handling problems arising from the economy and how do they handle the problems?

3. Why do many countries admire the efficiency of economic construction in the mainland?
The following three countries used different methods to tackle the basic economic problems in allocation of resources. Read the following information carefully and answer the questions.

**Case 1: Wahaha Island**

Our ancestors have accumulated hundreds of years of experience and wisdom to establish the unique customs and rules of the Sacred Tribe. We carry out different production activities in different seasons such as growing sweet potatoes, fishing and cattle farming.

**Patriarch of the Sacred Tribe - Mr Sherlock Kidd**

Division of labour takes place in every single family of the Sacred tribe and our unique production methods are passed on from generation to generation. For example, our Baha Family uses unique production method to make fishing baits and fishing device. And it works well! Our fish catch is the most in the entire tribe. We are proud of that!

**Eldest Son of the Baha**

Our patriarch will allocate the resources according to traditional customs and practices established by our ancestors. In the first day of each month, father or the eldest son of each family will go to the altar and receive food and materials, and the patriarch will allocate the resources by the status, number of members and also merit of each family. The higher the social status, the more materials they will get! However, the status of females in the tribe is low and we cannot succeed to any property at all.

**Mrs Baha**

Students can learn the three basic economic problems and different economic systems by analysing the three cases below as prior knowledge for understanding the economic system of China.
1. From the above three conversations, please identify the three basic economic problems faced by a society.

<table>
<thead>
<tr>
<th>Patriarch of the Sacred Tribe</th>
<th>Eldest Son of Baha Family</th>
<th>Mrs Baha</th>
</tr>
</thead>
<tbody>
<tr>
<td>What to produce?</td>
<td>How to produce?</td>
<td>For whom to produce?</td>
</tr>
</tbody>
</table>

2. What is the method used to tackle the above three basic economic problems in Wahaha Island? What economic system does Wahaha Island belong to?

Wahaha Island mainly relies on traditional customs and practices to tackle the three basic economic problems. This economic system is called “traditional economy”.

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Case 2: The Republic of Wuchuchu

Most of the resources in the Republic of Wuchuchu are state-owned and allocated by the government. For example, government leaders will set the production target for outputs, decide on the allocation of resources and the production methods after discussing with officials of Ministry of Economic Development and experts every year. Lastly, our nationals can go to the government “Rationing Center” to receive necessities according to their number of family members. As far as I know, many countries admire the efficiency and fairness of the economic governance of our country!
Based on the information provided by Case 1 to Case 3, try to compare the economic systems of the three places and complete the following table:

<table>
<thead>
<tr>
<th></th>
<th>Case 1: Wahaha Island</th>
<th>Case 2: The Republic of Wuchuchu</th>
<th>Case 3: Florence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major method to tackle the three basic economic problems</td>
<td>Social customs/practices</td>
<td>Government command</td>
<td>Determined by market / price mechanism</td>
</tr>
<tr>
<td>Major resources owner(s)</td>
<td>Some are owned collectively by citizens, some are owned by private individuals (Determined by social customs /practices)</td>
<td>Government</td>
<td>Private individuals</td>
</tr>
<tr>
<td>Economic system</td>
<td>Traditional economy</td>
<td>Planned / command economy</td>
<td>Market economy</td>
</tr>
</tbody>
</table>

I like Florence. I like its fairness, liberty and autonomy! We can earn money to buy what we want and have my own personal assets and properties. As a merchant, I will try to maximise profit and produce goods with the lowest cost. Moreover, we decide what to produce and their quantity according to the market price. Of course, the more popular the product is, the higher its price will be, and we will increase the production quantity of the product accordingly. Finally, one can get the product as long as he can afford to pay for it! Through the market price mechanism, Florence can allocate the resources more efficiently.
4. As the Minister of Finance of the Republic of Wuchuchu, Mr Ali thinks that the country’s method of governance is “highly efficient” and “fair” and such method is admired by many other countries. Try to think from his point of view and explain why such an economic system is “highly efficient” and “fair”? 

In a planned economy, economic development is guided by government command. Time for discussion and negotiation can be saved, so Mr Ali thinks that such method is relatively “highly efficient”. It is because most of the resources are state-owned. The government allocates the resources according to the needs of the people so that it would be easier to achieve the “fairness” principle as defined by the government in the allocation of resources.

5. However, merchant Peter thinks that Florence is a place where real “fairness” can be found instead. Why?

Peter and Ali have a different understanding on the meaning of “fairness”. Peter thinks that true “fairness” goes with autonomy. It means that people can earn money based on their ability and make their own choices in the market.
6. In your opinion, what is the inadequacy of the views of Ali and Peter respectively? Whose views do you consider to be more reasonable? Try to explain your answer by referring to example(s) in Hong Kong.

Ali stresses on the efficiency of government commands during the allocation of resources and the people can get what they need, but he neglects the fact that the government may not have perfect information. For example, the government may not have perfect information on the needs of consumers and the most efficient production method. The government has to spend a long time in persuading the people and lawmakers to legislate and implement policies. In addition, the welfare provided by the government will sometimes reduce people’s motivation to work.

On the other hand, Peter stresses on the freedom enjoyed by people in choosing their work and consumption according to their willingness and ability in the market. But he neglects the fact that the less competitive group can only earn low income, which may result in an uneven distribution of income.

Therefore, efficiency and fairness cannot be achieved by the government or the market alone.

Take Hong Kong as an example. The economy of Hong Kong stresses on free and open market but there are still some government policies to promote economic development and to reduce the income gap of citizens. For example, the establishment of minimum wage is to ensure the quality of life of low-income earners. Therefore we can see that government commands and free market are complements for the achievement of efficiency and fairness.
Before understanding the role of the government in economy, we must master the following three basic economic problems: 1) What to produce? 2) How to produce? 3) For whom to produce? In general, there are three different methods to tackle these three basic economic problems, which result in three types of economic systems, namely, 1) traditional economy; 2) planned economy; 3) market economy.

**A. Three basic economic problems**

1. **What to produce?**
   Due to the fact that people cannot produce unlimited products, they have to allocate the resources for producing products that people need most. As a result, it is important for people to decide on the types of products to be produced and their quantity as well.

2. **How to produce?**
   People have to decide on the production method to prevent wastage. For example, where to produce, the production modes and resources required, etc.

3. **For whom to produce?**
   People have to decide on the end users of the finished products.

**B. Different types of economic systems**

1. **Traditional economy**
   Traditional economy is commonly found in rural area and villages. Issues like “What to produce?” “How to produce?” and “For whom to produce?” are decided according to traditional social customs and practices.

2. **Planned economy**
   In planned economy, the three basic economic problems are all handled by government planning and commands. The government plans the production and economic development, and then decides on the allocation of resources and distribution of outputs.

3. **Market economy**
   In market economy, the three basic economic problems are all determined by market price. Both
producers and consumers transact in the market. According to the information provided by the market price, people decide on “What to produce?” “How to produce?” and “For whom to produce?” For example, when the demand for a specific product increases, its price will go up and the producer will increase the output accordingly in order to earn a greater profit.

4. **Mixed economy**

Nowadays, it is difficult to find a pure traditional economy, pure planned economy or pure market economy. In reality, market mechanism is adopted by most economies to tackle the above three economic problems. However, government will normally intervene the market at the same time through some commands or policies to tackle the problems emerged in the market. This is called mixed economy. For example, employees and employers in Hong Kong can freely negotiate the wage rate, find jobs or hire people. However, the government implements minimum wage ordinance to protect non-skilled workers, who are less competitive in society, and help them to earn a comparatively higher income.

Which type of economic system the following cases belong to?

1. According to one of the traditional customs of the rural villages in the New Territories of Hong Kong, which is called “pork distribution by the head of the clan”, males are entitled to a portion of pork each in the ancestral hall.

   **traditional economy**

2. From 1955 to 1993, the mainland issued food coupons with which people can buy food. At that time, people living in cities and towns can buy food, like pork, oil and rice, only if they have coupons.

   **planned economy**
3. Owing to global warming, people are more concerned about environmental issues. Demand for environmental-friendly vehicles hence increases, leading to increased price. Some automobile factories put a lot of efforts into the development of environmental-friendly vehicles in order to increase the market share.

4. As the price of spam imported from the mainland keeps rising, the operation cost of tea restaurants in Hong Kong increase as well. So, the owners of some tea restaurants decide to change the menu from spam noodles to ham macaroni started from next month.

5. As the housing price of some mainland cities like Beijing and Shanghai keeps rising and has reached an unreasonable level, the general public cannot afford it at all. Therefore, the Chinese government implements some policies, like restricting residents on buying a second flat and the housing price in those districts finally drop.

Guidance for teachers: For students of higher ability, teachers can further discuss with them to identify the features that belong to market economy (people living on the mainland can freely choose to buy their first flat according to their ability and preference) and features that belong to planned economy (the Chinese government restricts people on the mainland on buying their second flats).
China is a planned economy before reform and opening up

Upon the establishment of the People’s Republic of China in 1949, our country adopted the planned economy which was implemented in the former Soviet Union. Most of the resources and products were gradually changed as “publicly-owned”, which means the properties are owned by the public or the state. Moreover, the country changed private enterprises to state-owned enterprises gradually and the central government would decide on the quantity of products to be produced and the allocation of resources.

Worksheet 1: The economic system of China before reform and opening up

Read the following sources and discuss what were the economic problems faced by China in different periods of time.

Source 1: People's commune during the period of 1958-1960

Our village has established people’s commune and production will be carried out collectively. People's commune is responsible for coordinating, allocating and owning all resources and tools for production and managing the production as well. In addition, our foods are also managed by the commune. Farmers do not dine at their homes but go to the public canteen for “communal pot” where food is allocated based on equalitarianism. At least we are now better than before! As the saying goes “No matter how much work you do, what you get is the same”. The most important thing is that we can have three meals every day!
The Cultural Revolution was an influential political campaign started from 1966 and was widely recognised as the most turbulent period of history in the PRC since its establishment in 1949, resulting in great damage to its economy, society and culture.

Cultural Revolution lasted as long as a decade with economic loss of 500 billion yuan. Production was either stopped or interrupted and food production was adversely affected. The GDP in 1978 was even lower than that in 1952. Among the 800 million farmers, 250 million of them could not solve the problem of food and clothing. The per capita GDP was just 76 yuan.

Source 2: During the period of 1953-1957, the Chinese government gradually changed private enterprises to state-owned enterprises

Just like the rural villages, people working in state-owned enterprises can enjoy “communal pot” too! We are now working in state-owned enterprises and feel less stressed than before. It is because no matter how the situation of the enterprises and our personal performance is, the state will still invest in the enterprises and we are guaranteed to get paid!

Source 3: Great Leap Forward Campaign during the period of 1958-1960

The state leaders launched the Great Leap Forward Campaign which focused on industrialisation and promoted mass steel campaign. Most of the manpower and resources were used to produce steel and the ultimate goal was to “surpass the UK, overtake the US” in fifteen years. This resulted in a significant drop in agricultural output. Moreover, people were encouraged to produce steel with indigenous methods. As the techniques did not meet the standards, a great deal of steel scrap was produced and hence lots of manpower and resources were wasted.

Source 4: “Cultural Revolution” during the period of 1966-1976

The Cultural Revolution was an influential political campaign started from 1966 and was widely recognised as the most turbulent period of history in the PRC since its establishment in 1949, resulting in great damage to its economy, society and culture.
In addition, during the Cultural Revolution, about 16 million youngsters were forced to participate in the “Down to the Countryside Movement” that they were ordered to “reform through labour work” in rural areas and lost their chance to further their studies. Also, intellectuals were forbidden to read foreign literature or learn the overseas technologies, which meant young people in that generation could not receive higher education and learn advanced technologies. China’s academic and scientific research was significantly lagged behind.

1. According to Source 1 to Source 4, try to analyse the economic problems which China faced before reform and opening up.

<table>
<thead>
<tr>
<th>Source</th>
<th>Economic problems faced by China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source 1: Movement of people's commune</td>
<td>● As people's commune implemented collective production and allocated food based on equalitarianism, the motivation of the farmers was dampened significantly and hence the productivity dropped, resulting in a significant drop in agricultural output.</td>
</tr>
</tbody>
</table>
| Source 2: Establishment of state-owned enterprises | ● Equalitarianism meant that state-owned enterprises workers got the same salary irrespective of their working performance, which dampened the motivation of the labour and led to low productivity.  
 ● Moreover, as private enterprises were changed to state-owned enterprises, managers did not need to be responsible for the gains and losses so that the enterprises might not adopt efficient and low cost production method, resulting in wastage of resources. |
| Source 3: Great Leap Forward Campaign | ● The government wrongly estimated the productivity of the country. Without the required production technologies, the target was too high to achieve. For example, the aim to “surpass the UK, overtake the US” in 15 years was just to pursue the target of large output blindly. As a result, a great deal of steel scrap was produced and this resulted in a severe waste of manpower and resources.  
 ● Significant drop in agricultural output meant that there was a great drop in food supply. |
2. In a planned economy, the government owns all the resources and determines what to produce. What are the problems that may arise?

Without full access to information and due to some policy objectives, the government is unable to plan all productions and allocate resources efficiently. This may lead to mis-allocation of resources or wastage. Labour efficiency tends to be low and they lack motivation to improve production efficiency.

3. Do you think that it is necessary for China to change the mode of “planned economy”? Why? If yes, what are your recommendations?

(Any reasonable answer is acceptable.)

Yes. Our country can use market mechanism more to tackle economic problems so that goods can be freely sold in the market and the labour can look for jobs in accordance with their own expertise. Furthermore, enterprises can produce what consumers need according to the information provided by the price. This can increase their profit and efficiency while reducing wastage of resources.
The economic system of China before reform and opening up

1. Introduction
In the early period of the establishment of the People’s Republic of China (1949), government focused greatly on the development of heavy industry. Though China was a short-of-capital agricultural economy, funds were channeled to the development of heavy industry through government intervention.

2. Economic problems before reform and opening up
   - **Imbalanced labour structure and low productivity:** Before the reform and opening up in 1978, although the infrastructure investment mainly focused on light industry and heavy industry and the national income was mainly generated from these two industries, the majority of the labour force was in agricultural industry. It led to imbalanced labour structure, wastage of labour and disincentive effect on workers.
   - **Inefficient usage of capital:** As the production and allocation of resources was determined by the central planner, it was difficult to sell the finished products within a short period of time. This reduced the liquidity and efficiency in the use of capital of the state-owned enterprises. Moreover, the central planner was not familiar with the production and operation of the enterprises, this resulted in misallocation of resources and wastage.
   - **Low living standard in rural and urban areas:** As the country invested heavily in heavy industry and neglected the basic needs of people, people’s quality of life was rather low.

Due to the above economic problems, China adopted reform and opening up policy in 1978 to handle the problems and stimulate economic growth.
In 1978, Deng Xiaoping, who was called “the chief architect of reform and opening up”, determined to implement the reform and opening up policy. He suggested “emancipating the mind and seeking truth from facts” and building a “socialism with Chinese characteristics” which set a solid foundation of reform and opening up.

The following were the key points and measures promoted by Deng during the implementation of reform and opening up:

- **Agricultural aspect**: Household contract responsibility system was promoted. After handing in a contracted fixed amount of output to the government, households could keep the remaining output.

- **Urban development**: Special Economic Zones were established in Shenzhen, Zhuhai, Shantou and Xiamen. Foreign investment was allowed to flow into these areas and boosted the economic development of these areas.

- **Opening up policies**: China became more open to the outside world, which allowed a larger quantity of imports, more countries to export their goods to China and larger variety of imports. Also, it encouraged foreign companies to establish factories in China and technologies could be imported from other countries. At the same time, large amount of students were sent to the West to study.
1. Do you think that Deng Xiaoping has suggested effective solutions to solve the economic problems facing China at that time?

Yes. The above methods could enhance the motivation and efficiency of farming as well as productivity of the whole country. Moreover, the establishment of Special Economic Zones could provide funds and experience for the country to drive the overall development. Foreign companies’ factories in China could help to improve the production technologies and production efficiency in China.

2. China had long been implementing planned economy. Do you think that there is conflict between the reform suggested by Deng Xiaoping and the planned economy itself?

(Any reasonable answers are acceptable.)

Yes. Market mechanism was introduced during the reform and it conflicts with the planned economy which stressed on state dominance.

No. This was just a government regulated market and was not truly dominated by the market.

Remark: There is no pure planned economy or pure market economy in the real world; generally all economies are mixed economies instead.
Development of the economic system of China after reform and opening up

After reform and opening up, China introduced the concepts like market economy and private property which transformed the economic system from pure planned economy into mixed economy. Although the main economic organizations and a large number of enterprises were still under the state control, market and private property were allowed to exist at the same time. The central government reduced interventions on economic activities and administrative commands gradually, so that there was room for the development of private enterprises so as to enhance productivity and economic efficiency of the country.

In 2003, the country further reconstructed the State Development Planning Commission and renamed it as National Development and Reform Commission (NDRC), which is responsible for formulating and implementing strategies related to economic and social development, annual plans, medium and long-term development plans and coordinating economic and social development. The work of the NDRC focuses on planning and monitoring various kinds of important economic indicators in order to propose important direction regarding economic policies and enhance economic development. The change of the job nature of NDRC implies that the role of Chinese government is no longer giving “administrative commands” alone, but rather to stress more on “market-oriented” policies. The role of the government is the leader providing general directions and strategies for the whole economy and there will be less intervention in the micro-economic operations.
What is “administrative commands”?  
“Administrative commands” means that government intervenes directly in economic activities. The “administrative commands” are administrative orders, guidelines, or requirements given by higher level government to that of the lower levels and they must execute them. “Administrative commands” are usually carried out by 1) formulating and executing economic and social policies and 2) preparing the budget of the country. The NDRC frequently issues orders, for example, a notice on reducing the price of refined oil (e.g. gasoline and diesel oil) was announced in July 2012.

What is “market-orientation”?  
“Market-orientation” means economic activities are carried out by means of market operation. People consume and produce according to the demand and supply of the market. In a “market-oriented” economy, government seldom intervenes. Industrial policy is one of the “market-oriented” state policies. Government reforms traditional planned economy by establishing and implementing industrial policies in order to improve the market system, introduce market competition, reduce wastage and boost development in different regions.

State Council of the People’s Republic of China is the highest executive authority of the country. There are many ministries and commissions under the State Council. Some of them are mainly responsible for formulating related economic policies, including: National Development and Reform Commission, Ministry of Finance, Ministry of Industry and Information Technology, People’s Bank of China, Ministry of Agriculture, Ministry of Commerce and State-owned Assets Supervision and Administration Commission. Functions of some of them are described as follows:

1. **National Development and Reform Commission (NDRC)**  
The National Development and Reform Commission is mainly responsible for formulating and implementing strategies of economic and social development, annual plans, medium and long-term development plans, monitoring economic and social development trends, analysing fiscal and
financial situation, promoting and coordinating the restructuring of economic system and implementing macroeconomic management.

2. Ministry of Finance
The Ministry of Finance is responsible for formulating and implementing the finance and tax policies as well as preparing government budget, dealing with and monitoring the expenses of the central government in respect of economic development, social security, employment and medical care and providing funding for those investment projects as well. In addition, it also drafts and monitors the laws related to fiscal policies, finance and accounting management.

3. Ministry of Industry and Information Technology (MIIT)
The Ministry of Industry and Information Technology is mainly responsible for formulating and monitoring policies related to the development of industrial sector and information technology, boosting the reform and innovation of the industries and enhancing its quality and competitiveness. In addition, it also responsible for the development of Small and Medium Enterprises (SMEs) and formulates policies and measures for the development of non state-owned economy. It also insists that the government should minimise its intervention to the operation of enterprises.

4. People’s Bank of China
The People’s Bank of China is responsible for formulating and implementing monetary policies, including managing the issuance and circulation of RMB, the interest rate of RMB and the foreign exchange rate, etc. As the central bank of China, it is also responsible for ensuring the stability of financial industry and monitoring the operation of financial market in China.

Source: Website of The Central People’s Government of the People’s Republic of China
In order to enable more people to buy their own homes, we decided to offer a 30% discount on mortgage loan interest rate to people who buy their first flat.

Relevant ministry / commission:
People’s Bank of China

We will fight for the implementation of tax reform across the country during the “Twelfth Five-Year Plan” period to increase government revenue.

Relevant ministry / commission:
Ministry of Finance
The Growth Plan for SMEs in the Twelfth Five-Year Plan was issued to boost the healthy development of SMEs, maintaining a steady and rapid economic development of the economy and achieving the strategic targets mentioned in the Outline of Twelfth Five-Year Plan.

Relevant ministry / commission:
Ministry of Industry and Information Technology (MIIT)

Scientific formulation and effective implementation of the Twelfth Five-Year Plan have great strategic significance to the transformation of economic development strategies and achieving sustainable development of China. So we will draw up the major policies carefully for reform and development in the Twelfth Five-Year Plan according to China’s specific conditions.

Relevant ministry / commission:
National Development and Reform Commission (NDRC)

This activity aims at enhancing students’ understanding of the factors which may affect the economic growth, e.g. tax rate, inflation rate and loan interest rate, and to provide foundation knowledge for the discussion on macroeconomic management of China.

Lead-in Activity: Competitiveness between countries

Basic information of two countries is listed below. By analysing the information, can you conclude which country may have a better economic growth?

<table>
<thead>
<tr>
<th></th>
<th>Republic of Wahaha</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per capita GDP</td>
<td>HK$ 8,000 (converted)</td>
</tr>
<tr>
<td>Profit tax rate</td>
<td>15%</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>4%</td>
</tr>
<tr>
<td>Average loan rate</td>
<td>2%</td>
</tr>
</tbody>
</table>

In our country, many people work in export related industries like manufacturing of textile and electronic goods. Foreign investors say the production cost in our country is lower and our exported goods are even cheaper after converted into their home currencies.
1. Can you conclude which country may have a better economic growth? Use the above information to explain your answer.

The Republic of Wahaha. It’s loan interest rate is low, which is favourable for firms to borrow money for investment. Low tax rate can also attract more local and foreign investment.

2. How can the government boost economic growth? Choose the correct answers and explain the reasons why that the relevant policies may help to boost economic growth.

<table>
<thead>
<tr>
<th>Tax rate/economic indicators</th>
<th>Adjust upward/downward?</th>
<th>Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits tax rate</td>
<td>downward</td>
<td>Enterprises can keep a larger portion of profits so that they have higher investment incentive</td>
</tr>
<tr>
<td>Economic Indicator</td>
<td>Direction</td>
<td>Description</td>
</tr>
<tr>
<td>--------------------</td>
<td>-----------</td>
<td>-------------</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>downward</td>
<td>Stable price means stable costs of living for the workers as well as stable production costs for enterprises</td>
</tr>
<tr>
<td>Average loan rate</td>
<td>downward</td>
<td>Investment cost drops so that there is higher investment incentive</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>downward</td>
<td>Lower export prices (in terms of other currencies) can stimulate export</td>
</tr>
</tbody>
</table>

Note: There is no unique translation for the term "宏觀調控" in the mainland. Sometimes, the terms like "macroeconomic management" and "macroeconomic control" are used. In western countries, the term "macroeconomic policy" is commonly used.

Macroeconomic policy refers to the government’s administrative measures or policies that attempt to deal with economic problem. Two general macroeconomic policy tools include monetary policy and fiscal policy which may help to stabilise the economy or stimulate economic growth.

1. **Monetary policy**
   In general, monetary policy refers to adjustment of money supply and/or interest rate so as to achieve targeted economic outcome.
   - **Adjusting money supply**: Increasing money supply leads to new injection of capital for the economy, so the enterprises can get the fund for investment at a lower cost and hence boosts economic growth. However, increasing money supply may also result in a rise of commodity prices, higher inflation rate and currency depreciation.
   - **Adjusting interest rate**: When interest rate is higher, people are more willing to increase their savings and reduce their borrowing, consumption and investment. When the interest rate is low,
people tend to reduce their savings and increase their borrowing, consumption and investment. It helps to stimulate production and economic growth as well.

2. Fiscal policy
In general, fiscal policy refers to the adjustment of government revenues and/or government expenditures so as to achieve targeted economic outcome.

- **Government revenues (Tax revenues)**: The government mainly relies on tax revenues to provide community services, infrastructure and other government related services. On the other hand, tax policy will affect the economic performance, economic growth and distribution of income. For example, the government may offer tax concession for a particular industry if it wants to support the development of a certain industry.

- **Government expenditure**: The government may provide various kinds of goods and services and redistribute the wealth of people by adjusting its expenditure. Government expenditure policies will affect the overall development of an economy. For example, the government can carry out large scale infrastructure projects like construction of ports, railways and airports. This can benefit the future economic development by enhancing the productivity and competitiveness of the country. Moreover, this will also create jobs immediately to reduce unemployment. Increase in government expenditure will also increase GDP and boost economic growth.

3. Implementation of administrative order
The Chinese government issues and implements laws, interim measures, guiding policies, concessionary policies and offers information services and penalises law-breakers in order to achieve the goals of macroeconomic management.

Why does the government choose to stimulate economic development by macroeconomic policy?
Case Study: How can the Chinese government deal with the current economic problems by means of macroeconomic management

Read the following two cases carefully and point out what economic problems China is facing and in what ways the Chinese government can deal with them.

Case 1

Chun and Yan are Beijing natives. They plan to get married and hope to buy a property before getting married. However, the housing price in Beijing keeps surging, which is far beyond their affordability. They feel hopeless and they hope the macroeconomic policies of the government can help to stabilise the housing prices effectively.

The Chinese government had once adopted economic and administrative measures to prevent urban housing price from rising too fast. They include increasing the loan interest rate, percentage of down payment, land supply and imposing restriction on the purchase of the second flat. In the work report of the two meetings in 2012 (National People's Congress and Chinese People's Political Consultative Conference), Premier Wen Jiabao proposed that 36 million affordable homes would be built in China during the period of the Twelfth Five-Year Plan and the coverage of affordable homes in urban area would reach 20% by the end of Twelfth Five-Year Plan. The NDRC would also strive to increase the supply of small-to-medium-size housing units to enhance the long-term stability and development of the real-estate industry.
<table>
<thead>
<tr>
<th>Economic problem:</th>
<th>The housing price keeps rising</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Specific measures</strong></td>
<td><strong>How does the market adjust</strong></td>
</tr>
<tr>
<td>Increase the percentage of down payment</td>
<td>The demand of housing decreases so that the housing price goes down.</td>
</tr>
<tr>
<td>Enhance the supply of affordable homes</td>
<td>The supply of housing increases so that the housing price goes down.</td>
</tr>
<tr>
<td>Restrict the purchase of the second flat</td>
<td>The demand of housing decreases so that the housing price goes down.</td>
</tr>
<tr>
<td>Increase loan interest rate</td>
<td>The interest payment for mortgage increases, the demand of housing decreases so that the housing price goes down.</td>
</tr>
<tr>
<td>Increase land supply</td>
<td>The supply of housing increases so that the housing price goes down.</td>
</tr>
</tbody>
</table>
Case 2

Recently, the rapid surge of food price in the mainland has drawn concerns of various parties. According to insiders, the NDRC and various local governments will launch a series of measures to stabilise the commodity prices.

Prices surge, especially the food price surge, is the major economic problem that the country has to tackle. The core intention of such measures is to try to stabilise the prices of staple food as quick as possible. When the price keep on increasing too fast and exceed a certain limit, the government will take administrative measures to restrict the increase. If the surge is too significant, the local governments may subsidise the agricultural sector by utilizing the “vegetable foundation fund” to prevent the price from rising continuously.

For agriculture products speculation, a stricter penalty will be introduced, in particular for corn and cotton. If hoarding is found, a maximum penalty up to 5 times the original one will be imposed. Economists pointed out that inflation is a very serious problem and the crux of the problem is money supply growing too fast. It is expected that the People’s Bank of China will soon increase the interest rate and it can help alleviating the inflation problem.

Source: Integrated reports (2010)
<table>
<thead>
<tr>
<th>Economic Problem:</th>
<th>Food prices rising too fast</th>
<th>Administrative orders</th>
<th>Through market adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Specific measures</td>
<td>Control the inflation rate and set the maximum retail price of various products</td>
<td>✓</td>
<td></td>
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<tr>
<td></td>
<td>Subsidise the agricultural sector to prevent the price of agriculture products from increasing</td>
<td>✓</td>
<td>(Note: The decision of providing subsidy is an administrative order; however, the effect on food prices due to the increase in supply of food is a market adjustment.)</td>
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<td></td>
<td>Impose heavier penalties on speculations and hoardings</td>
<td>✓</td>
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<td></td>
<td>Increase the interest rate</td>
<td>✓</td>
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China consumes 35% of coal, 35% of steel and 30% of chemical fertilisers of the world every year and its demand for petroleum keeps increasing too. This situation is detrimental for sustainable development. Energy saving and reduction in emission is inevitable. So the NDRC launched a series of measures in 2007 to place strict checks on "high-energy-consuming, high-emissions, resource-dependent" industries and imposed harsh entrance requirement for these industries. The deputy industrial policy officer of the NDRC said in a forum that the NDRC would implement the “discriminatory water price” policy and “discriminatory sewage charge” policy in order to reduce energy consumption and alleviate environmental pollution. And a nationwide survey would be conducted this year to evaluate the implementation of the discriminatory electricity price policy and let those backward enterprises to be closed. The NDRC began implementing a trial phase of the “discriminatory electricity price” policy for 6 energy intensive industries as early as 2004. Certain high-energy-consuming enterprises have to pay a higher electricity rate.
The deputy officer said that there would also be export duty policy to inhibit the export of products of enterprises which were "high-energy-consuming, high-emissions, resource-dependent". In addition, qualified enterprises are also entitled to a tax concession of 15% to encourage them to become more proactive in technological innovation. The government also vigorously promoted R&D and the application of advanced energy technologies.

Source: The Central People's Government of the People's Republic of China

1. Point out the message expressed in the comic reading in Source 1.

   Source 1 shows that the government placed strict checks on "high-energy-consuming" industries and "high-emissions" industries and also ordered those enterprises to carry out restructuring, otherwise they have to stop production.

2. According to Source 2, what measures did the central government take to build an energy saving society? How can these measures help to attain energy saving targets in China?

   - The government implemented the “discriminatory water price” policy and “discriminatory wastage charge” policy and “discriminatory electricity price” policy, etc. Enterprises which consume much water, produce heavy pollution and consume much energy need to pay a more expensive water bill, sewage bill and electricity bill. Those backward enterprises are forced to leave the market, as they bear a much higher cost of production.

   - The government also restricted the exports of "high-energy-consuming, high-emissions, resource-dependent" industries by imposing a heavier export duty.

   - It also encourages innovation of enterprises via tax concession.
Concept map of role of Chinese government in the economy

The State Council of the People’s Republic of China

Organizations mainly responsible for economic policies
- NDRC
- MIIT
- Ministry of Finance
- People’s Bank of China

Macroeconomic management

Monetary policy
- Money supply
- Interest rate

Fiscal policy
- Government revenues
- Government expenditures

Administrative command