

Economic System Reform and Restoration of Confidence in Economy

Baodong Ren

Business School, Wenzhou University, Wenzhou 325035, China

E-mail: wsyrbd@163.com

Abstract

It is of particular significance to restore confidence during economic crisis. Government's financial policies, currency policies and other supporting policies will help to restore confidence to some degree. But, excessive reliance on government policies may result in another wave of inflation and economic crisis. As a result, the reform in economic system and the improvement of economic environment should be fundamentally relied on to restore confidence, which will help to upgrade industries, innovate technologies, develop economy harmoniously as well as to restore the confidence of investors and consumers, hence benefiting long-term and sound economic development.

Keywords: Confidence, Economic system, Economic environment, Reform, Improvement

1. Introduction

In the current financial storm, China has displayed extraordinary power in resisting against financial storm and economic crisis due to its government's financial policies, currency policies and other supporting policies. Meanwhile, the confidence in conquering financial storm cannot be neglected. Just as what Premier Wen Jiabao said, confidence is of the greatest importance, even greater than gold. In economic theory, confidence is also said to have great importance in economic activities as a psychological phenomenon. It is pointed out in the theory of market economy that economic subjects make their own economic decisions based on their prediction of future economic conditions. Their degree of confidence can be reflected in the future economic conditions they have predicted (Huang, 2007).

The degree of confidence displayed among most people regarding future economic conditions will have an impact on the operation of macro-economic through economic decisions and conversely the operation of macro-economic will further verify and enhance people's prediction over the future. Thus, confidence and economic operation fall into a circulatory state, where they promote or harass each other, no matter in inflation or deflation.

In the circulation between confidence and economic operation, economic environment also stays in variation with the constant development of macro economic situations (including both passive and active variations). Once people's prediction is reversed due to the variance in economic environment, people's confidence is also reversed, so is the development of economic conditions. During the regular conversion of confidence among people, a regular rule is also displayed in macro-economy, that it, economic cycle.

Economic cycle is unavoidable in market economy, so economic crisis will fade away finally. However, if left unsettled, the degree of economic recession will possibly be greater, even unbearable for the whole economic society. Enterprises' bankruptcy will put the whole industry into a recessive process and unemployment may cause the turbulence of social lives, or more possibly, influence the long-run development of economy. Certainly, there are many inter-related factors which may influence economic cycle and economic crisis. This paper only tries to elaborate on how to reduce the time for economic crisis and the degree of economic recession as well as how to restore sound and long-term development of economy from the perspective of confidence.

2. The Function of Currency Policies and Financial Policies

Ever since Keynesian revolution, currency policies and financial policies have become standardized means and methods which were employed by governments to control inflation and deflation. After World War Two, those nations with developed market economy have maintained 30 years' economic growth. Now, many countries with new-born market economy have also regarded government's currency and financial policies as an important method to adjust macro-economy and to strengthen manufacturers and consumers' confidence.

Nevertheless, there are also limitations in currency and financial policies.

2.1 Short Term of Currency and Financial Policies

Only with excessive capacity and a large amount of inactive resources will currency and financial policies realize their coordinative roles on economic recession. In the current financial storm and economic crisis, in spite of excessive capacity in China, most of it is labor-intensive for European and American market. In order to solve this, industries need to be upgraded and transferred to be fit for domestic market. This transfer includes establishing domestic sales system, developing products fit for domestic market and moving industries to middle and western underdeveloped areas in order to increase these areas' income and consumption and to increase domestic demands.

2.2 Adverse Effect of Currency and Financial Policies

The implementation of currency and financial policies may produce some adverse effects, such as excessively long time lag of currency policies. In extreme cases, liquidity trap exists and excessive currency input has also formed a potential threat to next inflation.

For a long time, our government's financial policies have been suffering from low efficiency and corruption. Currently, government's financial input goes mostly to basic facilities, which are capital and technology-intensive input and cannot produce many employment opportunities. Those unaccustomed to economic development are attributed to unfavorable economic environment, imperfect systems and incomplete institutions.

In addition, direct transfer payment also serves as a common financial policy, such as distributing vouchers, which, in spite of increasing people's temporary income, fail to improve income substantially or to bring about constant consumption increase.

2.3 Currency and Financial Policies being not the Necessary Condition to Calm down Economic Fluctuation and to Improve Economic Growth

Currency and financial policies have to depend on certain preconditions as well as other factors to exert their functions, such as system and institutional basis accustomed to economic development and economic environment fit for economic development (Zhuo, 2007; Zhang, 2003).

3. The Roles of Economic System and Economic Environment

No matter inflation or deflation, regular economic fluctuations show the drawbacks in economic system as well as the limitations in economic environment in addition to some superficial factors such as overflow or insufficient effective demands. The current economic systems, institutions and environment are no longer fit for the demands of economic development.

In order to solve confidence insufficiency among people during the economic crisis, those economic systems and institutions unaccustomed to economic development should be reformed and the unfavorable economic environment should be perfected in addition to rapid currency and financial policies.

3.1 A Review of Economic Crisis Administration in History

In U.S., it is President Roosevelt's New Policy that reformed and established a series of economic systems and institutions and therefore restored people's confidence. After that, government's policies and measures exerted their remarkable functions.

In Japan, ever since the burst of economic bubble in the 1990s, its government has implemented currency and financial policies for a long term, only to yield poor results. The basic reasons lie in that those economic systems and institutions unaccustomed to economic development haven't been fully reformed and amended and therefore people's confidence is not fully restored. As a result, government policies have failed to exert their functions sufficiently.

In the financial crisis in 1997, Chinese economy was badly influenced and suffered from recession. Chinese government implemented active financial policies to help Chinese economy out of the lowest ebb, especially some reforms in economic system have helped to improve the economic environment, to restore and establish manufacturers' and consumers' confidence, hence fully exerting the function of positive policies. For example, people's passion to have their own houses has been inspired by the reform in housing system, so have investors. The development of real estate has propelled a series of industries, such as building materials, steel, architecture, and has greatly increased job opportunities as well as national incomes; the increase of national incomes has driven the consumption of living basics, hence the development of the light industry; the trading of land has also increased the income of the local government, hence greater development in urban construction and urbanization. Therefore, the real estate industry has become a pillar industry in Chinese economy.

In addition, the prosperous development of the automobile industry inspired by the reforms in automobile production and consumption system, as well as the reforms in exchange rate system and China's progress in the exporting industry encouraged by the entry into WTO, has all shown the significance of institutional reforms for the enhancement of confidence.

3.2 Problems in Current Economic System and Economic Environment

3.2.1 Disorderly Economic Order and Serious Vicious Competition

Currently, disorderly economic order and serious vicious competition exist in China to some degree, which, as a result, have badly influenced investors' and innovators' confidence, prevented enterprises from expanding their scales and harassed their technological innovation and industrial upgrading.

Institutional factors responsible for disorderly economic order and serious vicious competition include incomplete intellectual property rights, ineffective execution in intellectual property protection, poor identification and monitoring sections, serious local protectionism, lack of unity in government orders, ineffective implementation of industrial and commercial management systems as well as ineffective restrictions of guilds and chambers of commerce and so on.

3.2.2 Low Government Efficiency and Unfair Market Competition

Lacking in necessary monitoring, government staff tends to consider more about their small collectives' interest or individual interest, causing rent-seeking and collusion between government officials and businessmen and therefore low government efficiency and unfair market competition. Since it is the unfair market competition that discourages investors and innovators, it is a good way to establish and reform government's monitoring systems and institutions in order to establish people's confidence.

3.2.3 Excessive Administrative and State-run Monopoly Preventing Private Capital's Passion for Investment

In order to enhance the confidence of private capital, administrative monopoly should be broken first of all to open those currently closed areas to private economy. In spite of our permission for some foreign capital into some economic areas since the entry into WTO, Chinese folk capital has been kept away, such as in some areas including education, culture, health care, media, law, arts and so on. In this sense, our domestic opening is lagging behind the foreign one.

It is hard to break administrative monopoly due to the attractive profit it produces. However, being not a permanent solution, it will quit the stage of history sooner or later. The earlier we break the administrative monopoly, the lower cost we may pay. By breaking administrative monopoly and opening economic fields, we will create millions of job opportunities.

3.2.4 Excessive Government Administration and Low Degree of Marketization

Excessive government administration and low degree of marketization have restricted the right investment direction as well as technological innovation and industrial upgrading. The cost for economic operation can be lowered by relieving a variety of economic management measures and improving the freedom of the economic system. In spite of the cheap labor forces in China, it has to pay a lot for its institutional system. It is well known that transaction cost serves as a target to compare different systems. Everyone in China, especially those running businesses there, knows that due to Chinese governments' super power, excessive controls instead of effective management have been conducted over economic operation, particularly over private economy. In order to earn extra profit, government departments are caring too much about something beyond their reach while leaving something necessary matters untouched. Dependent on both market and government, enterprises find it hard to conduct their economic activities.

Only by eliminating unreasonable economic controls, enhancing macro-economy management, improving economic freedom and creating an institutional environment for all economic sections to have equal competition will Chinese folk investment be greatly developed, the employment rate and household demands be greatly improved and economic growth be sustained, hence improving the efficiency of economic growth and developing economy sustainably.

3.2.5 Imperfect Property System

Unclear state-owned enterprises' property and imperfect property agency system are still blocking China's economic development. In economic prosperity, these problems may be hidden, while they may arise in economic crisis. Especially after the breaking up of state-owned enterprises, they will suffer from more serious passive situations. Therefore, the reform in property systems is also a good way to inspire state-owned enterprises' enthusiasm, to improve their efficiency and to enhance the confidence in economic development

(Chen, 2009; Han, 2010).

4. Suggestions on Reforming Economic System and Improving Economic Environment

Some people say that insufficient domestic demands should be the major concern when solving economic crisis. But in my opinion, the issue of supply should be solved first if we want to solve domestic demands, that is, innovating and upgrading industries in the eastern coastal area and developing some industries fit for their own local specialties by learning from the eastern area in the western underdeveloped area. In this way, employment opportunities and incomes can be increased, especially in the middle and western underdeveloped areas, hence really solving insufficient domestic demands.

Actually, both central and local governments have adopted some supporting and encouraging policies to promote industrial innovation, upgrading and transfer. However, due to the uncertainty caused by imperfect economic system, incomplete economic system and unfavorable economic environment, investors and manufacturers suffer from insufficient confidence and people in this field are devoted more to rent-seeking instead of production and innovation.

Accordingly, it is the key and basis to economic system reform and economic environment improvement to establish investors and manufacturers' confidence. In spite of the direct reason that the financial crisis in U.S. triggered European and American economic crisis and subsequently influenced China's domestic demands, China's former unfavorable economic system and environment have caused reduced profit from investment and some potential problems in macro economy. Therefore, in order to enhance our nation's ability to resist against economic crisis and to achieve long-term sound economic development, reform in economic system has to be conducted and economic environment should be improved.

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