UNIVERSITY OF MACAU
FACULTY OF SOCIAL SCIENCES AND HUMANITIES
DEPARTMENT OF ECONOMICS

Government Size and Economic Growth of China in the Reform Period

by

LIN Son Sam, Sam (M-A5-6801-8)

A thesis submitted in partial fulfillment of the requirements for the degree of Master of Social Sciences at the University of Macau.

August 2007

CONTENTS

Abstract i
Declaration ii
Acknowledgements iii
List of Tables & Figures vii
Abbreviations viii

Chapter One Introduction 1
1.1 Background of Research 1
1.2 Research Objectives 6
1.3 Significance of Research 7
1.4 Structure of the Thesis 9

Chapter Two Literature Review 11
2.1 Introduction 11
2.2 Theoretical Considerations 11
2.2.1 The Initial Discussions 11
2.2.2 Government in the Keynesian Economics 13
2.2.3 Absence of Government in Neoclassical Growth Theory 13
2.2.4 A Vital Role of Government in Endogenous Growth Theory 14
2.3 Empirical Evidence 16
2.3.1 Evidence based on Cross Section Methods 17
2.3.2 Evidence based on Time Series Methods 20
2.3.3 Evidence based on Panel Data Methods 22
2.3.4 Evidence Addressing Optimal Government Size 25
2.4 Major Differences in Empirical Studies 28
2.4.1 Different Measurement of Government Size 28
2.4.2 Variations in Theoretical Framework 29
2.4.3 Various Econometric Methods 30

2.5 Summary and Implications for this study 31

Chapter Three The Role of the State in Chinese Economic Transition 33

3.1 Introduction 33

3.2 Overview of Provincial Economic Growth 34

3.3 Government Size in the Reform Period 36

3.4 The Role of the State in Chinese Economic Transition 38

3.4.1 To Promote and Guide Institutional Reforms 39

3.4.1.1 Agriculture Reform 39

3.4.1.2 State Owned Enterprise Reform 40

3.4.1.3 Financial Reform 41

3.4.2 To Provide Public Goods for Chinese Economy 44

3.4.3 To Form Strategic Plans for Economic Development 45

3.4.4 To Maintain Macroeconomic Stability 47

3.5 Conclusion 48

Chapter Four Methodology and Data 50

4.1 The Theoretical Framework 50

4.2 Data Description 56

4.2.1 Output (Y) 57

4.2.2 Labor Force (L) 57

4.2.3 Gross Investment (I) 58

4.2.4 The Size (Output) of Government Sector (G) 58

4.2.5 Consumer Price Index (CPI) 59

4.3 Preliminary Test for the Stationarity of Variables 60

Chapter Five Empirical Results 62

5.1 Introduction 62

5.2 The Overall GSEG relationship in China 63

5.3 The Externality Effect of Government Sector and the Intersectoral

Productivity Differential in China 69

5.4 Conclusion 72

Chapter Six Conclusion 75

6.1 Summary 75

6.2 Policy Implications 77

6.3 Limitations and Future Research 78

Bibliography 80

Appendix 86