Economic reform in China: Problems and future prospects

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ECONOMIC REFORM IN CHINA—PROBLEMS AND FUTURE PROSPECTS

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In 1978, China announced plans for economic reform and opened her door to the outer world. Today, ten years later, China has experienced significant changes in various areas under the waves of reform. This paper introduces the Chinese model in a developing a "socialist economy." It briefly explores and analyzes the Chinese model of a centrally planned economy, and the economic development from 1949 to 1978. Then, the economic reforms since 1979, which include such internal and external environmental influences as the Cultural Revolution and the open door policy, will be discussed. Progress of reform since 1979, which includes budgetary devolution, reform of the state economy, reform of the urban collective and individual sector, as well as the commune sector will be explored. Key points of China's economic achievements since the economic reform of 1979 will be discussed briefly. Finally, future prospects for economic reform are discussed in relation to the obstacles to progress, since economic reform depends on the progress of political, social, and ideological reform. Concerning the above issues, the paper reviews some works by several economic experts on China.
Currently, China faces many obstacles to the progress of economic reform and the development of the economy. These include traditional resistance to reform (the party apparatus and ministerial bureaucracy, and old ideologies), political factors (inconsistency and instability of politics, and lack of comprehensiveness of democracy and law), economic factors (lack of comprehensiveness and internal consistency of the reform and need of some economic variables), and human problems (overpopulation, and the spiritual situation of the Chinese people).

One objective of this paper, therefore, is to review the development of the economic reform since 1979 and to explore current bottlenecks for further economic development. With reference to the past records and current development, this paper also tries to explore various factors affecting the future of economic reform and development and to pursue the future of the reform.

China is a giant in all aspects but one. Her history spans three thousand years; her artists, men of letters, and inventors have contributed greatly to the advance of world culture and civilization; with almost one-quarter of the world's population, the numbers of her people are staggering; the size of her territory is comparable to other world powers; the industriousness, ability, gentility, and occasional cruelty of her people are second to none; and their fighting ability, when aroused, is awesome.¹ The one
aspect in which China has been less than a giant is economic.

Another objective of this paper, therefore, is to explore the Chinese model of economic development—a central planning system, which can in part explain the backwardness of Chinese economy.
Literature Review

Since 1978, with the open door policy of China, more and more Western economic experts have started to discuss the issues of the Chinese economy and have written a great many articles and works. This chapter reviews some of the current literature about the Chinese economy.

Peter Knight, an economic expert from the World Bank, explored in detail the Soviet model of a central planning system adopted by "socialist" countries including China. He pursued the model in five aspects: ownership of the means of production, the locus of economic decision-making, price formation, incentives to producers, and competition. Although simply an abstract, his description of what may be called the traditional central planning system is quite clear and understandable. He also examined the economic reforms in "socialist" countries. From the reform experiences of those countries, he suggested that the success of reform depended largely on "the strength of political support, the comprehensiveness and internal consistency of the reforms, the length of time they are
pursued without interruption, and the availability of some economic slack."

While Peter Knight's comments on the central planning system and economic reform are quite general, Gregory Chow gave a more specific description of a central planning system with a Chinese style. As a professor of economics at Princeton University, Chow explored the features of the Chinese model of economic planning in terms of the interrelationships among individual consumers, enterprises, and the government in the market and the roles they played. He also pointed out that the economic reform since 1979 is leading China toward a more market-oriented economy. However, because of the forces holding back the reform such as "ideological resistance, vested interests, bureaucracy, inertia inherent in economic organizations, and the lack of education among the middle management personnel in government and in state enterprises," he noted, "precisely how far the reforms toward adopting features of a market economy will go in the next decade is difficult to predict." Chow further stated that the market forces would be by far "the major means used by the Chinese government to achieve its planning objectives."

The same opinion is held by Robert Dernberger. According to Dernberger, "the program of economic reforms being pursued by the current leaders in China is a modification, not a replacement, of the traditional Soviet-
type economy." As for the future of the reform, he further stated that "the economic results of the economic reforms introduced thus far are so impressive that the leadership,..., will be convinced of the economic benefits" (and/or be forced) to continue the economic reforms, even including systemic reform.

In terms of current obstacles to economic reform and development, the World Bank covered in detail the purely economic factors: the prevalence of the old system, the distorted price system, and the need for some economic resources such as arable land, foreign exchange, and energy. It is obviously true that China faces a tough task ahead to deal with this "resource crisis," as Dwight Perkins pointed out. However, Perkins put more emphasis on political support; "The greatest uncertainty about China's economic future lies in the realm of politics." He further stated:

If the political environment does remain supportive, there is every reason to believe that China will undergo an economic and social transformation with many features similar to those that occurred elsewhere in East Asia. If this change does take place, one-quarter of the world's population will have moved in the latter half of the twentieth century from a closed, poor, rural, peasant society to a society where living standards are rising rapidly, where the dominant share of the population is increasingly urban and industrial, and where the nations of the region are fully integrated into the international economic system.

By contrast, Chow was more optimistic about the future of economic growth in China. From the fact that the Chinese economy was able to grow from 1952 to 1979, despite the adverse conditions of inefficient central planning and two
very serious political disturbances, he noted, the economy would continue to grow greatly even though the economic reform progressed slowly.
Chapter 2

The Chinese Model of Economic Development

After 1949, the year the People's Republic of China was founded, China adopted, with few modifications, the system of centralized physical planning practiced in the Soviet Union. This model served the Chinese economy for more than thirty years.

I. Traditional central planning system

China's economic system combines a largely urban state economy, similar to that of other socialist countries, with a rural commune economy of its own invention. The state economy is characterized by public ownership, centralization of economic decision-making, strictly hierarchical control, and little reliance on markets or prices. To a greater degree than in East European countries, people's jobs and consumption patterns are chosen for them by the state.

Ownership of the means of production

Since 1949 there have been three forms of ownership in China: state, collective, and private. Although their composition and relative weight have changed over time, none has ever been fully obliterated. State ownership, in Chinese parlance, means assets owned "by the whole people." In
theory, these assets belong to the country and its people as a whole, and on their behalf the state administers them. Collective ownership, by contrast, refers to assets which are the property of definite sub-groups who work with those assets as in the case of productive resources or who produce them or use their income to purchase them. For example, a production team's television set is owned by the team, not the state. Likewise, the assets of an urban collective workshop, run by a neighborhood committee, belong to the neighborhood denizens or the workers who purchased them.

In industry, all significant means of production are state owned. The urban collectives are nominally owned by their members but for most practical purposes they are indistinguishable from state-owned enterprises. Private enterprises account for a very limited percentage of the industrial economy.

In agriculture, cooperatives are the dominant form under strict state control; state farms, which are owned and operated on the same principles as state industrial enterprises, are second; and finally, there are private farms on individual household plots, assigned to but not formally owned by the families which cultivate them.

The locus of economic decision-making

Economic decisions, both macro and micro, are in the hands of the state government. China's system of economic
management, modeled after the Soviet system adopted during the Stalin era, is "extraordinarily centralized and characterized by strict vertical control, with relatively few horizontal linkages." The central plan specifies a large number of value aggregates and physical inputs and outputs in the economy. The structure of the plan is strictly hierarchical, and the targets set by the central government are dictated to the local authorities and enterprises regardless of their suitability. Different levels in the hierarchy can bargain over production assignments and the allocation of the means of production for carrying them out: materials through administrative orders; labor via controls over the size (and sometimes distribution) of wage expenditures; and capital through the allocation of investment funds, construction materials, machinery, and equipment. The country's revenue from most sources and expenditures for public undertakings and investments are controlled by the central government. On the local level, a sum of money may only be used as designated, and only a small portion of the local tax income is at the disposal of the local authorities. In the commune sector, production and investment decisions are less subject to central direction than those in the state economy (including state farms), and market and prices play a larger role.

Price Formation

Virtually all prices have been set by the government
through a hierarchy of price bureaus. The central Price Bureau maintains a book specifying which prices are subject to central, and which to provincial or sub-provincial control. Prices for most commodities are set by the state. The prices of agricultural and industrial goods of national importance (around two thirds of total production) as well as transport tariffs on major national routes are subject to national control. The prices of other goods, local transport tariffs, and charges for social services are controlled by provinces or counties.

As for foreign trade, which is carried out by special export-import firms, domestic prices are separated from world prices by a plethora of taxes and subsidies. As of 1978, the exchange rate has played a very limited role in domestic price formation. Producing firms have no direct contact with foreign customers or suppliers.

Incentives for producers

Material incentives are not widely used, and they are also limited by the extent to which policy-makers are willing to tolerate personal income differences. Numerous aspects of the planning and management process have inhibited both the capacity and the willingness of enterprises to produce products of good quality, over-fulfill the plan by too large a margin, or operate at minimum cost. Production levels at one period have been the planners' basis for setting targets of the next period.
Other inhibitors of incentives are the cost-plus pricing policy and the free availability (up to rational levels) of capital, material, and labor.\textsuperscript{11}

There has been little incentive for either management or workers as their performance bears no relationship to job security or to income. There is a phenomenon called the "iron rice bowl" (permanent employment), which means workers are hired but not fired and promoted but not demoted. Once an employee enters an enterprise, he can expect to spend the rest of his working life there no matter how he does his work. Also, workers derive few benefits or losses if the enterprise makes a profit or incurs a loss. They are paid according to centrally prescribed wage scales rather than for individual skill and performance. If the enterprise makes a profit, most of it will be collected by the state, while in the case of a loss, the state will cover it through subsidies. This is known as "big pot meal"—everybody eating the rice from the same big pot (of the state).

\textbf{Competition}

Because of China's central economic planning system, enterprises have no need and/or capability to worry about any business decisions such as producing, marketing, or financing, to meet the demands of the market or compete with others in the market. Enterprises, in general, interact "vertically" through their respective hierarchies rather than "horizontally" through the market. Production and
distribution enterprises tend to be large and many have regional or country-wide monopolies in their specified activities. Businesses are opened but seldom liquidated as a result of inefficient production and management. By and large, competition is limited to efforts at plan fulfillment and over-fulfillment.

II. The economic development 1949-78

Recovery and consolidation, 1949-52

In 1949, when the Chinese Communist Party founded the People’s Republic of China, the nation was faced with unemployment, inflation and starvation. To deal with these problems, the leaders undertook a series of new economic policies. The most sweeping of these was the land reform in rural areas where land and other assets were redistributed from the rich landowners to the farmers.

In the industrial sector, drastic nationalization was avoided and a fairly positive approach was taken towards existing private industrial firms. While still under state control, they were sometimes encouraged to expand, while at other times only tolerated in their present forms. By 1952, China had more or less recovered her pre-1949 peak of economic activity. The economic system did not change drastically.

Socialist transition, 1953-57
In this period of the First Five Year Plan, the institutions for bureaucratic central planning and management in industry and commerce were established, mainly following the Soviet model. Private industrial firms came under government control by nationalization, leaving the former owners nominal shares of the profits. In 1953, many private firms were converted to joint state-private ownership, subject to the same state planning and management as the state-sector enterprises. By 1956, the private sector in industry had been eliminated. Two-thirds of the gross industrial output value was produced in state-run plants with only one-third in joint state-private firms. The state was fully in command of China's industry.13

In agriculture, cooperatives were organized, making possible direct planning based on output targets and acreage allotments. By 1956 over 90 percent of the Chinese peasants belonged to cooperatives. For the first time since 1949 agriculture began to be exploited while investment priority was given to heavy industry.14

The Great Leap Forward, 1958-59

In 1958 Chairman Mao Zedong launched the world’s most extraordinary economic venture—the Great Leap Forward. This venture was a reflection of Mao's dissatisfaction with Soviet methods and his attempt to find a Chinese way for economic growth. The Great Leap Forward was a bold program to achieve phenomenal progress on all fronts through
traditional rural labor methods, the mobilization of the masses for heroic tasks, and, from these efforts, to "enter communism." Mao's ambitious program was beyond the production possibility of the Chinese economy at this time. In the end, it coincided with the withdrawal of Soviet assistance and a succession of natural disasters (drought), resulting in economic failure.

Within one year after the Great Leap, the agricultural cooperatives were transformed into communes, thus making it possible to place the economic activities of the Chinese rural population under direct government control.

The events of this period demonstrate how, in a centrally planned economy, mistakes made by one single political leader can lead to national economic disaster. This circumstance has played and will continue to play a very significant role in China's political, economic, and cultural development.

Recovery and readjustment, 1960-65

Because of the failure of the Great Leap Forward, by late 1959 and early 1960, not only had agriculture and light industry been badly hit, but the rate of growth in heavy industry had fallen to virtually zero. The Chinese leadership, no longer dominated by Mao, began to make fundamental changes. More liberal economic policies were introduced, including private plots for farmers. Most important was the priority given to the development of
agriculture such as added emphasis on rural industries, agricultural machinery, and chemical fertilizers. In December 1964, when Premier Chou En-Lai addressed the Third National People's Congress, he reported the recovery of the economy and suggested that China pursue the Four Modernizations: industry, agriculture, defense, and science and technology. By 1965, the economy was growing rapidly in a balanced way, reaching a national output level that was over 60 percent higher than that of 1961. In the following year, the Cultural Revolution burst in the skies above China.

The Great Proletarian Cultural Revolution 1966-76

The Cultural Revolution is also called the "Ten Years of Turmoil." The Chinese administrative and economic system, as well as the cultural and educational system, were under severe attack by millions of Red Guards. Unlike the Great Leap Forward, which was launched to remedy economic problems, the Cultural Revolution was mainly a political struggle, although economic issues were argued. Economic policies became dominated by political slogans rather than economic considerations.

In the name of destroying the old cultural traditions, which were blamed for hindering social revolution, the Red Guards grasped political power from "persons in authority taking the capitalist road" and transferred it to the radical elements of the Communist Party. The ensuing
political turmoil, plus the demands for higher wages by workers, resulted in a resolution to freeze all prices at the end of 1966. This situation lasted for over a decade and prevented the proper functioning of China's price system. During this period, the cultural and educational systems were also severely hurt. Higher education practically ceased; total enrollment dropped from 674,000 students in 1965 to 48,000 in 1970. Millions of the best and brightest—a whole intellectual generation—were exiled to the countryside to get "reeducation from peasants." The results of the Cultural Revolution are still being felt in current economic reform.

Failed compromise, 1977-78

During 1977 and 1978, Hua Guofeng, the Premier and Party Chairman since 1976, attempted to find a middle ground between the rival policy positions and their respective leaders and followers. On one hand he led a decisive coup against the "Gang of Four" leftist leaders and their supporters, and on the other hand he continued to judge the Cultural Revolution as a success. In agriculture he continued to develop the Dazhai/Xiyang program of advanced collectivization that had dominated the 1960s and 1970s. In industry he continued to support the left's industrial model—Daqing oil-fields. With slogans associated with the Great Leap Forward, Hua envisaged "a new period of development." He put forward a new ten-year plan with high
goals to be achieved mainly by dint of great sacrifice and effort of the people. This was unattainable under the economic conditions of that time. For example, the ten-year plan called for the development of the equivalent of ten new Daqing oil-fields while the reality was that there were no immediate prospects for even one new oil-field of that size. The situation was not changed until the end of December, 1978.
Chapter 3

The Economic Reform since 1978

In December, 1978, the Third Plenum of the Eleventh Party Central Committee was held. Deng Xiaoping, a highly committed reformer, and his supporters scored a decisive victory, and the path to the subsequent program of reform was cleared.

I. Pressures for reform

There are many factors influencing the reform: both internal and external.

Internal factors

The traditional central planning system had made a significant contribution to the economic transformation of China. When China was initially freed from a protected feudal rule and from the Western blockade, when her battered economy still lay in ruins, when technology and productivity were backward and low, and when the social framework was primitive, this system played a very important role in pooling meager resources, funds, and skills, rehabilitating
the devastated economy, and implementing economic reconstruction.

This system, however, over-centralizes decision-making power, minimizes producers' autonomy, hinders the development of a commodity economy, minimizes the role of market prices, and reduces producers' incentives, all resulting in a lack of flexibility, inefficiency, and waste. The economic system has long been a stumbling block to national economic development and must be thoroughly overhauled.

The inherent deficiencies of the system, especially in the state run economy, have long been recognized in China. The discussion of system reform in 1978 was actually a resurrection of the intense debate of the late 1950s and early 1960s. Unlike previous debates, criticism of the system in 1978 was based on widespread disappointment with the performance of the economy, in particular with the slow improvement in the general standard of living for two decades after completion of the socialist transformation in the late 1950s, and with the fact of persistent poverty in some parts of the country. The pressure for economic reform thus stemmed partly from the country's changing priorities, especially the growing concern with consumption. Pressure for reform had also arisen from the recognition that future development must be based on more efficient use of resources rather than on mobilization of resources as in the past, and
from the awareness that maintaining growth and modernization would be difficult in isolation from international technological development.

Politically, the social and political stabilization was another issue. By 1976, almost twenty years of "leftist" mistakes had dragged the Chinese economy to the brink of collapse. The biggest mistake was the Cultural Revolution, which not only ruined the economy, but also reduced the people's support and lowered the party's prestige. If this situation had continued a few more years with increasingly deteriorating living conditions, the People's confidence in the CCP and its ideology would be shaken even more, and it was highly possible that a politically unstable situation would occur.

External factors

In 1978, China opened her door to the outer world and began to establish normal relations with most Western countries. This offered China a more favorable opportunity in the 1980s to increase her participation in international trade. Meanwhile, this required a more flexible economic system.

After nearly 30 years of isolation from the outer world, China finally opened her door to modern Western management, science and technology, culture and ideology. Most impressive to the Chinese people were the economic accomplishments of the West and the living standards of its
people. Chinese people, including the party members and cadres, realized that after the "ten years of turmoil" they were behind other nations. While complaining and criticizing, the majority of the Chinese people hoped and urged the government to make changes to "catch up with the others" (actually shorten the distance between each other.) Since 1979 the most important changes have been in economic reform, both in policy and structure of the system.

II. Progress of reform

There have been many changes in the system of economic management since 1979 although some important issues remain unsolved. On some fronts the changes have been substantial, while on others, minor. They represented the beginning of economic reform that had great consequences for the country in the past and will continue to have in the future.

Basically, the reform sought to improve the management and efficiency of lower level administrative and economic units by giving them greater responsibility and autonomy; linking income and rewards more directly with output and production; and relying more on the market and indirect economic instruments instead of administrative measures to influence their activities. The major components of the reform may be summarized as follows:

Readjustment
The reform process started with the implementation of policies called "readjustment" which were aimed at improving living standards by increasing the share of consumption in national income, giving much higher priority to light over heavy industry, and seeking greater benefits from foreign trade.

Budgetary devolution

Beginning in 1980, a formal revenue-sharing system was introduced to give greater autonomy to provincial governments. Each province was allowed to retain a fixed proportion of the revenues it collected, which determined its total expenditure. Within this total, the provincial government was also given more freedom in choosing the composition of its expenditure. This reform was intended to stimulate provincial revenue-gathering efforts. Most provinces were also permitted to retain, besides a specified fraction of industrial and commercial tax revenues, all the profits remitted by provincially and sub-provincially controlled enterprises.53

Reform of the state economy

1) Ownership of the means of production

China basically completed the socialist transformation of the means of production as early as 1956, but pushed too fast and too hastily far ahead of the state of economic development. Since 1979, there have been great changes in terms of ownership of the means of production, basically in
the collective and individual sectors. In the state economy, there has been no major change in formal property rights. State ownership still plays the dominant role in the national economy. Within the state economy, no big institutional changes have taken place. Some small corporations such as restaurants were sold out to collective corporations or individuals. Some other corporations issued "stocks"—but only a small number of shares—in the market. What changed most has been operational, i.e., the means of operation to separate ownership from management. Beginning in 1982, a leasing or contract system was put into practice, allowing some medium-sized and small businesses to be leased or contracted by individuals or collectives from the state and run virtually as private companies. The lessee pays taxes and rent for the use of the shop or the factory and keeps the rest of the profit—or absorbs the losses if any. For large and medium-sized enterprises, the contract system was introduced. The manager, on behalf of the enterprise, contracts with the state to render a certain amount of profit and keeps the rest over the contracted amount.

2) The locus of economic decision-making

One of the central dimensions of the economic reform has been the attempt to change the relationship between the state apparatus and the state enterprises through the policy of expanding enterprise autonomy (kuoda qiye zizhuquan). Since 1979, enterprises have been given greater decision-
making powers with respect to the use of retained profits, production planning, sales of output, experimentation with new products, expenditures of funds, capital expansion, and personnel administration. In 1983 the director responsibility system was introduced, under which factory directors assumed full responsibility for their factories’ production, operation, and management.

For example, in terms of production, enterprises may now choose, in light of demand and their comparative advantage, what to produce once plan quotas are met. In personnel management, they have the right to distribute bonuses at their own discretion, with the guidelines stipulated by the state. They are even given the right either to impose penalties on workers, who through negligence incur severe economic losses for the state, or to dismiss those whose performance is unsatisfactory, though real cases have been few. In terms of foreign trade, more enterprises are being given the right to export their products and to retain a portion of the foreign exchange thus earned. This foreign exchange can, in turn, be used for the import of foreign technology, equipment, and raw materials if approved by the acting authority as absolutely necessary.

3) Price formation

The uniform price system has been replaced with a three-tier price system. The state sets the prices only of
those goods on quota that are essential to the economy or to the people's living standard; for above-quota goods, the state either sets up a price ceiling below which fluctuations are allowed within a specified range; and potential buyers and sellers can negotiate prices, except those of products under state unified purchase. In practice, prices in the street markets are not regulated, and the prices of nonessential manufactured consumer goods, formerly controlled mainly at the county level, have been deregulated. While producers may freely dispose of their above-quota output, they may also bargain with the buyers such as other enterprises and retail stores. There are also some conventionally administered adjustments of specific prices to correct distortions that affect profitability and production decisions.

4) Incentives to producers

There have been more incentives to producers in terms of profit retention. In 1980, more than 6,000 industrial enterprises participated in the national experiment, surrendering 87 percent of their profits, retaining 10 percent for themselves, with 3 percent used for repaying debt and other prescribed expenditures. About 80 enterprises were also selected by their provincial government administrations to operate independently, being responsible for their own profits and losses and only paying taxes instead of turning over their profits to the state and
retaining all profits after taxes. This tax system was applied nationally in 1984, generating relatively more local initiative and efficiency in terms of management and operation. Despite many technical problems and many issues of debate, the purpose was obvious—to create an incentive system for enterprises so that increasing profits or cutting losses was rewarded by more retained profits. Retained profits may, within limits, be used at the disposal of individual enterprises. They are encouraged to use a substantial part (up to 40 percent in practice) to pay worker bonuses based on individual or group performance and to improve worker welfare, especially housing. The remaining 60 percent is to be used for investment to improve, modernize, and expand the enterprise’s productive capacity. Under the contract system, the enterprise has to reduce the retainable profit and employee bonuses if the contract is not fulfilled. Together with the depreciation allowance and maintenance funds, the enterprise can innovate, renovate, and expand production. In the wage system, wages vary according to enterprise revenues. For workers, rewards are still not tied to individual performance because wage increases and bonuses are distributed equally. There is, however, an increased use of bonuses and a greater use of piece rates as incentives. In 1986 China introduced a system of labor contracts for factory workers. Now new workers are encouraged to sign
contracts to work for up to three years in factories. Once the contract is finished, the worker has no further right to a job or benefits. If there is a need, the workers may be reemployed.

5) Competition

As a rule, an enterprise that pursues the principle of division of labor and produces on a large scale can lower costs and win in competition. Since 1979, various models of vertical and horizontal coordination and integration have been produced. The first model pools together all factories producing similar products into a specialized corporation. The second model consists of state enterprises incorporated with factories owned by cities or towns or production brigades. The third model involves an integration between regions providing raw materials with regions processing the materials. The fourth model consists of agriculture-industry-commerce jointly operated enterprises, i.e., factories and affiliated stores join with state farms or production brigades to engage in manufacturing, processing, and marketing. The fifth model comprises various types: corporations such as joint-venture with foreign capital, and single-venture by foreign corporation.

Operationally, competition is also generated. There are many more distribution channels than before. Producers have also been allowed to establish their own retail outlets for above-plan sales. Wholesalers are no longer obliged to
purchase the whole of a producer's output, especially manufactured consumer goods, but can be somewhat more selective about what they buy and from whom. Likewise, retailers are no longer obliged to purchase only from local wholesalers, but can buy above-quota products directly from local producers and seek goods in other localities or regions. In terms of marketing, there are more and more commercials appearing on TV, radio, and in other media.

Urban collective and individual sector

In the past it was believed that state-owned enterprises were superior to collective or individual enterprises because they represented ownership by "the whole people". The urban collective and individual sector, therefore, had been greatly neglected in China. On the one hand, individual and small collective activities had declined in importance since the 1950s, and by the mid-1970s they had nearly disappeared. On the other hand, large urban collectives had been managed much like state enterprises, with little autonomy.

In 1979 the new leadership began to replace the past policies of restricting, discriminating against, and even eliminating the sector of private ownership with a policy of active direction, proper promotion and better control. As a result, in the cities, unemployed workers were urged and encouraged to create cooperatives or to set up private businesses. They provided goods and services demanded not
only by individual consumers but by state enterprises as well, which they could sell in "officially controlled," but relatively free, markets. Because of the high profitability of the individual businesses, many workers in state or collective enterprises quit their jobs and started their own businesses. By the end of 1980, more than 800,000 people were operating individual businesses, compared to about 300,000 people in the previous year, and in 1981 the number passed 1.1 million. Likewise in 1980, employment in urban collectives grew twice as fast as that in state enterprises. In 1981 the employment in urban collectives reached nearly 25.68 million workers and staff—almost one-quarter of the national total.

In terms of allocation of energy, materials, and credit, urban collective enterprises have been given higher priority than ever before. They have also been given more autonomy in purchasing, production, sales, human resources management, and financial planning. More and more collective enterprises have been granted a lease or a contract under the "economic responsibility system" to operate more or less on their own. By the end of 1984, over 11,000 industrial enterprises and 58,000 commercial enterprises had reportedly been rented out.

The commune sector

The reforms in the commune sector since 1979 have undergone several phases. First was the restoration of the
rights and responsibilities of the commune and its subordinate units (brigade and production team) in their role as collectives, especially for the latter, and they were encouraged to implement the principle of distributing income in proportion to work accomplished. Meanwhile, private household plots were expanded rapidly. By 1982, the household plots were increased to 15 percent of the total cultivated land, compared to an average of 6.4 percent during the Cultural Revolution.35

Then came the wide adoption of the household responsibility system, in which individual farmers signed contracts to hand over fixed amounts of produce and sell the extra to local markets for higher prices. Collective work broke down, land was subdivided into household tracts, farm machinery acquired collectively by the brigade or the production team was either subdivided, sold, leased or distributed by the collectives to individual peasant households. In late 1981 the household responsibility system was officially acknowledged as universally acceptable. At that time, 45.1 percent of production teams had already switched to this system and by the end of 1983, 97.9 percent of production teams had adopted it.36

The institutional collapse of the People's Commune was the third, and maybe the final, phase. According to China's 1982 Constitution, the People's Commune formally ceased to exist as an integrated unit of self-government. Instead,
township (zheng) and village (xiang) bureaucracies, under the administrative hierarchy of the provincial bureaucracy, replaced its political and administrative functions. So called "village committees," which replaced production brigades, administer several villages (formerly production teams) whereas the township administers up to a dozen villages. By 1984 the township and village government was established in most parts of the country. 37

In 1985 the second stage of the rural economic reform began with the abolition of the state monopoly over the purchasing and marketing of major farm products. Except for a few selected products such as tobacco and medicinal herbs, which are under government contract, all other products are now sold by peasants on the market at market prices.

III. Economic achievements of the economic reform

Since the reform of 1979, China has experienced impressive economic achievements. Real economic growth has averaged 10 percent a year for the past 8 years. This figure underestimates the true growth because China's definition of GNP excludes almost all the service sector, while services were growing by over 25 percent a year in 1984-86. Reform, then, seems to have increased overall growth by two percentage points to a rate which doubles real GNP every 7 years. This is especially remarkable for a nation of more
than 1 billion people with limited resources and technological know-how. In less than 10 years China’s per capita income more than doubled from $150 to $350. In the market there are greatly increased amounts and varieties of food, clothing, and consumer goods.

China’s agricultural reforms are regarded as a huge success and have improved the lives of 800 million Chinese farmers. Farm output rose by between 4 percent a year (for grain) and over 15 percent (for cotton) in the 9 years after 1978. China’s farmers increased their earnings by more than they did throughout the first 30 years of communist rule, from 134 yuan per capita in 1978 to 424 yuan per capita in 1986. Many peasants who lived in mud huts a few years ago are building brick homes, more and more of them equipped with TV antennas poking through roofs. For the first time in history China has enough grain to export and to feed a population of more than 1 billion. The results in industry to date have been less impressive. However, the industrial output of the state sector increased by 81 percent from 1978 to 1986 while that of the urban collective rose 220 percent, albeit from a much lower base. Workers’ living standards have also increased with increasing income. In cities, three-bicycle families—the equivalent of three cars in a U.S. suburban garage—are now commonplace. More and more families are replacing their old small black and white TVs with larger color TVs.
The sad story is that the agricultural miracle is over unless policy is revamped. Furthermore, the industrial reform has only marginal impact in the cities and now also faces obstacles.
Chapter 4

Current Obstacles to the Economic Reform

I. Traditional resistance to reform

Traditional ideologies and conventional influences

The time's not been long since the individual economy once again took up its legitimate place in the arena of our country's economic life. Since the Third Plenum of the Party's Eleventh Central Committee (December 1978), the majority of people have enthusiastically welcomed it, some people examine it with a suspicious eye, (and) part of the people reject it with disgust in their hearts.41

These lead lines come from an early 1983 People's Daily newspaper. They alerted their readers to the fact that, some four years after China's top party leaders had unequivocally endorsed the petty private sector with its open-air fairs and its sidewalk stalls, a range of opinions still sliced up the popular stance toward this business. This is not uncommon.

As a dynasty, Maoism in China is little more than a quarter of a century old; but as an organized movement, Chinese communism is sixty years old. On the other hand, China's history can be traced back three thousand years with a feudal ideological system based on the doctrine of
Confucius and Mencius, and its weight on the present is still enormous. Therefore, it would be wrong either to underestimate both the resolve and the capacity of the communists to uproot old customs and habits and replace them with a "newborn socialist thing" or to discount the staying power of tradition. Traditional thinking and habits enforced by a self-reliant natural economy and a "socialist" experience of more than 30 years, long-ingrained beliefs and fear, and self interest all played part in the people's "reasoning" of economic reform.

The present system has remained in force for more than thirty years so many people are used to it. Some comrades are still wondering if reliance on the market forces, capital and land charges, production for profit, and material incentives are compatible with socialism. Others have fears that systemic reforms would mean loss of party control over the main directions of the economy and that liberalization in the economic sphere might lead to demands for liberalization in the cultural, social, and even political spheres. A change in the economic system will also affect vested interests in certain special interest groups. The party and the state bureaucracy fear that they would lose power if enterprises were free to respond to market forces. Managers selected more for their political reliability than for their entrepreneurial skills are less than enthusiastic about reforms that require them to sell
products in a competitive buyers’ market, and workers want to know how price changes associated with reforms will affect their real income."

II. Political factors

Political support and policy stability

Economic reforms inevitably influence the distribution of power and income and may at the same time bring some negative side-effects. They thus require strong political support if they are to be successful. However, there have been two major setbacks for economic reforms in China since 1979, both started first in political and cultural areas. In 1983 the campaign against "Spiritual Pollution" (that is, contamination by bourgeois Western life-styles and ideas) sent a chill through the Chinese intellectual community and created tremendous confusion among party members and ordinary people.

In January 1987, after students’ demonstrations for more democracy and freedom, Mr. Deng Xiaoping launched a bad-tempered attack on intellectuals and party members who had allowed a debate on "political reform"—meaning liberalization and democratization—to be carried on in China’s press for the past year. The debate raised the question whether Mr. Deng’s economic reforms would lead to a political loosening that might one day erode the party’s
monopoly of power. At the same time, the conservatives used the official press to launch a campaign against "Bourgeois Liberalism," the new code-word in China for anything the party decides is out of line. These two setbacks, while affecting the steps of economic reform, signified the instability of political support.

Party image and bureaucracy

The Communist Party is the only acting party in China. On the principle that the party provides leadership for the state (the administrative organs of government), and the state manages the economy, the party determines basic policy. Party leadership is exercised both centrally and locally. Although party members comprise only a small percentage of the adult population (6-7 percent in 1983), they still occupy most of the responsible jobs. This fact points out a crucial question: whether or not they are eligible or responsible for their positions. Party image, therefore, is very strategic when the party is leading its people in building the Four Modernizations. However, because of the failure of the Great Leap Forward and ten-year turmoil of the Cultural Revolution, the party's image was badly hurt during those periods. Furthermore, the problems of corruption and bureaucratic privilege occurring since the economic reform of 1979 are a greater inherent danger to the future of the reforms, as they evoke public discussions of luxurious consumption and corrupt behavior and threaten to
undermine public confidence. Dwight Perkins stated:

For nearly three decades China’s leaders extolled the virtues of working selflessly for the common good. Party members, in particular, were expected to live by those principles. In reality senior officials, including party cadres, were paid substantially higher wages than ordinary workers and received other special privileges,...... but the special privileges of the elite were largely hidden from view behind the closely guarded gates of Zhongnanhai in Beijing and other similar places where the elite lived. Conspicuous consumption was a formula for personal political eclipse. Those without political power basically lacked the means to get rich.45

By the mid-1980s, however, party cadres have had to sit back and watch others with less influence and power get rich. Without a legal way to enrich themselves, many give in to the temptation to turn political power into economic gain.

Besides party image, bureaucracy is another issue. The bureaucratic system that the Communists have established for more than thirty years is a huge obstacle to economic reforms. Characterized by overlapping and ill-defined jurisdictions, the bureaucracy is a large, self-serving, enormously complex and unwieldy, highly politicized system. Theoretically, the response of units at the bottom to changes of policy at the top is remarkably quick and uniform. In China, however, that is not necessarily the case. There is a phenomenon described in a popular saying: "for every policy of the central government, there is a counter-policy at the local level." Although top leading officials may have a sense of urgency, most of the rank and
file at lower levels show little zeal for change. These bureaucrats have become accustomed to "eating three full meals a day yet doing no work without revolutionary will."

In factories, party secretaries can watch over, and most of the time outrank, factory managers. Besides, there is a staff of party members in the offices of the Public Security Department, the Communist Youth League, and the like doing non-production work in a factory; and the factory is held responsible for all their salaries.

The comprehensiveness of democracy and law

According to American economic experts, there is a need for comprehensiveness of democracy and law if the economic reform is to succeed. Economic reforms don't automatically change the basic structural features of Chinese politics. There has never been a truly pluralistic system in China, in the sense of either sufferance of a variety of contending ideologies or tolerance of an organized competition for political power independent of party control. The system of one-party rule hinders the free flow of ideas and the process of change and adaptation. The press remains a centrally coordinated instrument of persuasion. Newspapers can criticize violations of policy, but not the policies themselves.  

Before 1979 China was a lawless society in the literal meaning of that term (there was not even a published criminal code.) In 1979 China started to reform the law
system. Some 300 laws and regulations have been adopted since 1979, 250 of them dealing with economic matters. China now has 2,900 local courts, 300 intermediate courts, 29 high courts at the provincial level, plus separate military and maritime courts. That's a great improvement over the Cultural Revolution, when rule was by mob. However, simply drafting new laws or having courts of various levels may not produce a fair legal system. Interpretation still depends more on changeable party guidelines as it moves party-appointed judges, usually retired officials or soldiers, than on the letter of the law. As Chinese people complain, "The rule of law in China has often amounted to little more than the whim of officials." They have so far paid little attention to legal procedure. The anti-crime campaign is an example. In 1983 top leading officials ordered a crackdown on crimes, calling for fighting crime more seriously, harder, and quicker (than the rule of law) while ignoring proper procedures. Also, there are big gaps in the legal edifice, e.g., lack of corporation or tort law. A satisfactory legal framework for commercial cases may not be ready for a decade or so.

III. Economic factors

The comprehensiveness and consistency of the reforms
Since the elements of reform are highly interrelated,
they should be mutually consistent and internally comprehensive if the reform is to be implemented successfully. China’s economic reforms, even before the political storm spread over Beijing, had run into trouble. While the agricultural three-quarters of the economy is being gradually freed from central control, the industrial one-quarter is still tightly controlled. The tension between the more liberalized and regulated parts of the economy is growing, and this is slowing the reforms. For example, increased state prices for farm produce in recent years have been mostly offset by the rapidly rising cost of agricultural inputs such as gasoline, equipment, machinery, and chemical fertilizers. This is no surprise because "reformed" agricultural produce is in relatively abundant supply while "unreformed" manufactured goods are scarce. The result is increased cost of agricultural produce and less profits for farmers.

Within industry, industrial prices bear no relation to scarcities either inside China or in the world. In China prices of all kinds of basic goods—from energy and steel to transport and investment—are so low that they are chronically scarce; prices of manufactured goods are comparatively high but demand is so great for some consumer goods such as TV sets that they are in short supply too. Under the conditions of all-round shortage, increased raw material prices will simply cascade through the economy
because many consumer-goods producers will be able to pass on all the increased raw material cost to customers.\textsuperscript{50}

Inflation, which has been such a great concern to consumers, has become an obstacle to price reform. In 1984-85, China eliminated price controls on all but 86 products and raw materials, bringing about that old "capitalist evil"—inflation, which has not yet abated. According to official figures, for the first six months of 1987 inflation in urban areas ran at an annual rate of about 10 percent, and some Western economists estimated that the actual figure was closer to 20 percent. The higher prices have been more painful for urban workers than for farmers and others. Wage increases in state-run enterprises lag well behind price increases. The price boosts of food and consumer goods have stirred widespread complaints and a fair amount of skepticism among consumers about the wisdom of price reform.\textsuperscript{51}

The availability of some economic slack

The transformation of the Chinese economy to modernization also faces many purely economic or technical constraints, the principal of which can be listed as follows:\textsuperscript{52}

a/ Arable land. Compared with its population of almost 1.1 billion people—almost one-quarter of the world's population, China has only 100 million hectares of arable land, about 7 percent of the world's total. While the
population is growing at an annual rate of 14 million, cultivated land has been reduced at an annual rate of 20 million mu (1.33 million hectares), an area equivalent to the farmland in Fujian province.53

b/ Foreign exchange. China faces a critical shortage of foreign exchange because reserves, which stood at $16.7 billion in 1984, fell by 40 percent in early 1986 to $10.35 billion. Projects that require hard currency are being postponed or even cancelled. The government is also finding it difficult to obtain foreign exchange to pay foreign investors while most foreign firms are accumulating huge reserves of Ren min bi yuan which can not be converted into foreign currency. Ren min bi yuan, while depreciating more than 200 percent since 1981 causing most foreign firms to suffer great losses, is still high against hard currency, hindering exports.

c/ Energy in all forms, with a special need for oil. The gross output value of agriculture and industry must be quadrupled by the end of this century, but energy supplies can only be doubled.

d/ Raw materials for light industry.

e/ Shortages of skilled people, especially managers, designers, engineers, and scientists.

f/ Lack of technical know-how, especially in fast changing areas like electronics, computers, and precision instrumentation and control systems.
g/ Inadequate transport and communication networks.

IV. Quality of the population

Population and family planning policy

For all the fear that turbulence at the top of the Communist Party will slow down China's economic reforms, one of the biggest threats to the country's prosperity is still its expanding population. In 1949 the population was about 540 million; the figure at the end of 1987 was 1.08 billion, with over 15 million more than that of 1986. Equally important, as many as 230 million Chinese are still illiterate.

Because of the strict one-child policy, the birthrate has slowed down. China came an impressive 14 million births under its official target for the five years up to 1985. However, the population ceiling of 1.13 billion by 1990 and no more than 1.2 billion by 2000 is unlikely to hold owing to resistance to the one-child policy and the arrival at marriageable age of China's Cultural Revolution baby boomers. Relying on a single child for support in old age still does not have much appeal in China, especially if the child is a girl. State-run homes for the elderly are scarce, and China is still a long way from nationwide welfare and pension schemes. Without a social security system, the best bet for a comfortable old age is still to have many
children. The reform in agriculture has also worked against the one-child policy. Most farmers now depend on the market instead of local officials for their income. Those who have done well can afford to pay the financial penalties for breaking the pledge of the one-child contract, especially one that could probably make extra profits by using another boy in the fields. In the meantime, even if China's one-child family planning policy helps to contain the population ceiling of 1.2 billion by 2000, there will be a further net population increase of 140 million between 1986 and 2000, a great pressure for China's limited resources.

**Spiritual situation of Chinese people**

Human resources are always the most important factor in any society at any time. This situation also applies to the current economic reform in China. For the reform to succeed, the Chinese people are expected to work hard and intelligently, or sacrifice their time, energy, and even their lives for the better of their motherland. In reality, the Chinese people—beaten, inspired, traumatized, runover, embraced and discarded by nearly four decades of zigzagging political movements—their energy and enthusiasm burned out during the Great Leap Forward and the Cultural Revolution, have been left with a crisis of faith, confidence and trust. There is a saying summarizing the general spiritual situation of Chinese people since 1949—"In the 50s people loved people; in the 60s people fought with people; in the
70s people were afraid of people; and in the 80s people ignore people (people take care of themselves)."

In the United States it is often said: "nothing ventured, nothing gained." But in China, "don't trouble trouble unless trouble troubles you." Chinese people tend to be more traditional and conservative. Those who are satisfied with what they have don't expect any changes while those who are not satisfied reluctantly "venture." In China there is a phenomenon called "Red-eye disease," which means people are envious of those who are rich and famous. Sayings such as "Big trees attract wind," "People are afraid to be famous just as pigs are afraid to be fat," and "Birds atop of trees get the first shot" all describe this phenomenon. Because "venture" is too difficult, challenging, and even troublesome, people prefer to be ordinary people instead of the target. The worst thing is that some people who themselves don't work hard "expect" others not to do so either.
Chapter 5

Future Prospects of Economic Reform

The future of China’s economic reform depends on many economic and non-economic variables, some of which are related to past performance, while others are not perceptible, or are quite simply inconceivable. The record (political, economic, or ideological) to date, however, can be of help in forming an educated guess about future options and prospects.

I. The progress of political reform

China is a socialist country and will remain one with features of the “Four Cardinal Principles”—the socialist road, Communist Party leadership, proletarian dictatorship, and Marx-Lenin-Mao’s Thought. Even though Deng is not by nature a democrat, he has realized that there must be some comparable political and social progress if economic reforms are to proceed. The 13th Party Congress of October 1987 called again for political reform. There is also some theoretical breakthrough of socialism. Ideologically since
1978, the question of whether a specific policy is capitalist or socialist has been central to many debates, and reformers have constantly found themselves on the defensive. To justify reforms, the reformers claimed that China is still in the primary stage of socialism—a long period allowing for capitalist and market-oriented experiments until a purer form of socialism is reached in the mid-21st century. This new ideology has stretched the limits of tolerance toward new economic forms, such as private and mixed ownership of the means of production and leasing, which are not normally allowed in a socialist economy.

Administrative reform

The separation of party and government functions is one major component of political reform. The party will be responsible for drafting principles and policies, while the government is in charge of actual implementation. The political reform also called for setting up a civil-service system for recruiting able professionals through examinations instead of the current cadre system that rests heavily on personal connections and loyalty to the party.

Administrative reform sounds fine in theory. In reality it will be hard, if not impossible, to put it into practice. In a state of one-party monopoly, party membership has long been a mandatory requirement for important positions in governmental and industrial sectors. Moreover, since the
party is still meant to be the font of all wisdom, it is hard to define where a member's job as a civil servant, an engineer or a manager begins and his party responsibilities end.

Political support and stability

China remains a nation dependent more on the power of a single leader than on an institution, and the party has the monopoly of power. This led to the disasters of the Great Leap Forward and the Cultural Revolution. Without a system of checks and balances there is nothing to stop some future party leaders from using party power to make the same mistakes as Mao did. So far Deng is a highly committed reformer, but what happens after him is still uncertain. Success of economic reforms, therefore, will depend largely on whether or not Deng's successors are as deeply committed to reforms as he and have the same power to carry them out.

On the other hand, the fact that in January 1987 Deng had to remove from the party secretaryship his heir apparent, Hu Yaobang, an outspoken reformer, suggests that the reformers are vulnerable to a counterattack from conservatives and reforms after Deng are uncertain.

Anyway, the party faces the dilemma that the economic situation will get worse if the party does not continue the reforms, whereas if the reforms do continue, the party itself will lose power to newly rich peasants and independent managers. Zhao Fusan, a senior scholar at the
Chinese Academy of Social Sciences, states flatly that "the process of economic reforms will naturally bring about a process of democratization, the setting up of checks and balances in political life and the rule of law," which are bound to threaten the party monopoly of power.

II. Social and ideological reform

For all that has changed in China, much remains the same. Many of its people—perhaps even hundreds of millions—are still beyond the reach of the reforms that have been made.

"Feudalism retains a hold on the ideology of today’s China," says Su Shaozhi, one of China’s leading political scientists. Mistrust of outsiders is little changed since Marco Polo first set foot in China. A farmer still refuses to build a house higher than the neighbors’ lest he be responsible for "raising troubles on their heads." The most important feudal influences are the preference for a self-reliant natural economy as opposed to a commodity economy, and authoritarianism in politics. As Su further stated, "unless there is a great change in the people’s way of thinking, neither political nor economic reform will be successful." However, the feudal influences can be completely extirpated only after a high-level of commodity economy is fully developed, the general level of education
and culture throughout society has been elevated, and the authority of democracy and law has been strengthened.

China does not have a tradition of legal codes designed to protect rights, life and property. The Confucians believed in a general code of morality and ritual and strongly opposed publicly promulgated laws. Chinese leaders, like their Confucian ancestors, often eschew a written legal code and resolve disputes before administrators rather than in adversarial legal proceedings. The role of lawyers is, consequently, severely limited. Under such circumstances, ensuring even a limited degree of a "rule of law" and limited respect for human rights in China has a long way to go.

From the American viewpoint, The first wave of Deng's reforms has vaulted China out of totalitarianism to authoritarianism without popular demand for more freedom. Most people remain apolitical in the aftermath of the Cultural Revolution and most place a premium on stability as well. Without widespread pressures for democracy from below, few fundamental changes can be expected. The future will depend on the ability and willingness of Deng and his followers to alter the ancient feudal traditions that helped Mao launch his peasants' revolution. Also, passive acceptance could fade once a higher living standard is reached. "You begin to get at a certain level a pressure for greater political liberalization," says Harry Harding, a
China expert with the Brookings Institution. "China is not at that point." Most ordinary Chinese are too busy making money, or worrying about price increases, to bother about such things. The richer China gets, the more chance there is of converting hearts and mind, and cementing policies.

III. Economic reform

When a country's per capita income increases from around $500 to $2,000, that country is in the first stage of economic development. This is a very critical stage because, at $500 per capita, the economy is still largely a peasant one with most families living on the land. At $2,000 per capita, the economy is more industrialized with less than 40 percent of the population concentrated on farming. Goods and news come in from all over the world to change the traditional ways of village life.

China's current GNP is somewhere between $300 and $500 per capita. In the vital first stage of economic development, China is employing a set of policies strikingly similar to those that have transformed South Korea and Taiwan and that have enabled Japan to be an industrial giant. China's aim is to quadruple real income to $800 per capita by the end of the century. This depends on the success of the economic reform.

General outlook
China is building "China with socialist characteristics." There is no explicit or implicit intention from the party to establish a capitalist market economy. What has changed in the past and will continue to change is the attitude toward capitalism. The purpose is to make the socialist economy function better with the help of ideas and methods which are typical of capitalism. This can be called "building socialism with Chinese characteristics." Therefore, China will continue reform toward a more market-oriented economy.

Economic reforms, so far, have been very successful in the countryside. So many Chinese farmers enjoy what the rural reforms have brought to them that even if reformers do not seize power after Deng, it may be very difficult to retreat from them. If there is political instability, however, economic reform will not come to a halt but will continue the zigzag pattern of the past three decades.

If the Chinese economy was able to grow between 1952 and 1979 with the adverse conditions of inefficient central planning and two very serious political disturbances, then the economy will continue to grow substantially even if economic reforms progress slowly. The only difference is that the economy will grow even faster with more favorable political and economic conditions.

Urban reform

During the early 1980s, most indicators of Chinese
industrial efficiency were rising slowly, and during the mid-80s, the number of state enterprises in deficit increased from 13 percent of the total in 1983 to over 15 percent in 1986. In the first quarter of 1987, one-fourth of China's state-owned enterprises were operating at a loss. Why has reform been so hard to undertake in cities?

The conditions that made success possible in the countryside are: 1/ Farmers were lent the underlying assets—the land for 15 years; 2/ farm incentives were tied directly to their performance; and 3/ price incentives were improved. None of these conditions for success exist in cities. Besides, to operate a large industrial enterprise efficiently is much more difficult than to operate a small farm. Large industrial enterprises are more dependent on factors outside their control than are small household farms. Given a piece of land, a farm household can produce as it pleases, subject to climatic conditions. A large industrial enterprise needs the supplies of equipment and of material input produced by other enterprises. Furthermore, urban and industrial reforms encountered more ideological and bureaucratic resistance than the rural reforms.

The complexity of urban reform, therefore, is a great danger to the reform process because it implies that mistakes in implementation are inevitable. Any mistakes will lead to setbacks in the economy and will undermine political
support for further reform. For the urban reform to succeed, much needs to be done with several essential and interrelated steps. Failure to implement one of these steps can undermine the effectiveness of the others.68

Based on the assumption that China is a socialist country, public ownership of the means of production will be the primary principle for how the economy may be organized. That, however, does not imply a particular form of management. The new theory of the separation of ownership and management has got official commitment that the state need not directly control what it owns. Instead, it can give up "the right to operate" while still owning the property. The theory will help in justifying business leasing, land leasing, and share selling in a factory to its workers.

The lease and contract arrangement is one means of separation. It was initially used primarily for small, often failing enterprises, and has been proved a success. As of mid-1987, 10,000 to 15,000 such arrangements had been set up, and approximately 95 percent were operating profitably.69 Therefore, the lease and contract system will be widely expanded in medium-sized and small enterprises, allowing individual or collective groups to lease or contract the operation of enterprises. For large and medium-sized enterprises, workers cannot be given industrial assets through the lease and contract system, because the cost of a lease depends partly on the factory’s capital, and a few
thousand workers could never afford to rent a $1 billion steel mill. Instead, the multiple contract operation system will be the primary form of operation.

Right now China’s economic planners are at odds over a chicken-and-egg dilemma. Which should be first: enterprise reform or price reform? If enterprise reform goes first, then managers must be judged on the basis of profit. They must be able to set prices that reflect both the true cost of inputs and market demand—impossible without price reform. But if price reform is to be implemented first, it will result in chaos unless managers, rather than party secretaries, have absolute power in running their enterprises. On the national level, reforming China’s price system always seems to be difficult. For one thing, long years of price stability have given consumers little tolerance of inflation. For another, freeing some prices before others is bound, at first, to cause more problems such as inflation and unemployment than it solves.

Considering inflation as a big concern to consumers and a potential threat to political and social stability, price reform will have to give way to price stability and be postponed until after enterprise reform. In October 1987, the Party Congress called for the separation of government and enterprise functions. The factory manager is to be the decision-maker and the one answerable to the state, assuming full responsibility for the production, management, and
operation of his enterprise. The party committee will be responsible for implementation of general principles, and enforcement of political and ideological education.

With wide acceptance of the lease and contract system and director responsibility system, each enterprise will become more economically independent. This provides the incentives and pressure for the enterprise to compete in a market through which the state indirectly regulates the enterprises. This is called: "The state regulates the market and the market guides enterprises." However, as long as factor markets in the economy are still more or less controlled by the state and certain commodities in some local markets are in short supply, the enterprise will not be able to fully compete in such a half-open market. Enterprises producing those commodities in short supply need not be efficient enough to survive.

Rural reform

Historically, in all countries that have been through the transformation from $500 to $2,000 in per capita income, there has been a marked shift in employment out of agriculture and into industry and services because peasants leave the land in droves and settle in cities. In South Korea, for example, the number of farmers fell by about a quarter from 1965 to 1985. China has 800 million peasants. A migration such as that which accompanied South Korea's industrial growth is unlikely to happen, but
industrial growth has to happen somewhere.

It is officially estimated that, by the end of this century, China's rural labor force will rise to 450 million. With increased productivity and mechanization, agriculture will absorb less than 30 percent of the available labor; forestry, animal husbandry and fisheries will take up the other 20 percent; less than 10 percent will be employed in cities or in factories and mines; and the remaining 40 percent (nearly 200 million peasants) can only enter rural industries, construction, transport, commerce, services and household-based industrial or sideline occupations. Therefore, rural industrialization is one way out for industrial growth.

The gradual concentration of land among efficient households has resulted in a widespread and acknowledged disparity in income. Those peasants unsuccessful in farming inevitably will have to give up their land to rich peasants and become employed in rural industries. This is called "leaving the land but not leaving the village" (li tu bu li xiang).
Chapter 6

Summary and Conclusions

In summary, this paper has tried to explore the Chinese model of a centrally controlled economic system, which is the main factor curbing the development of the Chinese economy. The economic reform since 1979 reflects China’s top leaders’ recognition of the inefficiencies of this system and their willingness and efforts to "remodel" the system to make it more efficient. The reform to date has made significant changes, especially in the countryside. But, efforts and achievements aside, the economic reform has encountered huge obstacles: traditional or conventional, political, economic, and social.

Ten years of economic reforms have passed in China. The policies of the reformers have brought tangible benefits to the nation and its citizens. People of all levels and from all occupations know that to realize the Four Modernizations and catch up with the rest of the world, China has only one way out: reform.

As a result, what is at stake is not the program of reform, but the scope to which it can reach and the pace at
which it will be pursued. Under the waves of reform, everyone has a different version and expectation of economic reform while most adopt a wait-and-see attitude. This poses a question: how to reform.

According to Chinese officials, economic reforms have already got a blueprint after 9 years of experimentation. This blueprint, while still very vague, can be changed any time, any moment. The future of economic reform still relies on political support and stability, and this political support and stability depend in turn on the success of economic reform. The road to reform can be seen as a maze, and, although zigzag, the trend is forward.


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9. Peter T. Knight 56.


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