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**Class structure and economic development: The contradictions  
of market socialism in China**

**Smith, Richard Anthony, Ph.D.**

**University of California, Los Angeles, 1989**

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UNIVERSITY OF CALIFORNIA

Los Angeles

Class Structure and Economic Development:  
The Contradictions of Market Socialism in China

A dissertation submitted in partial satisfaction of the  
requirements for the degree Doctor of Philosophy  
in History

by

Richard Anthony Smith

1989

The dissertation of Richard Anthony Smith is approved.



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1989

For Bob, Rick, and Nancy

This dissertation is dedicated to the three individuals without whose encouragement and support it could not have been written. Bob Brenner helped me conceptualize key central issues and reorganize early drafts, and pushed me incessantly to finish it. Though no China specialist, Bob saved me from many errors, and I owe to his insights far more than is attributed here. I hope his influence will be apparent throughout. Early on, Rick Baum befriended this would-be China specialist, and gave me the tremendous encouragement I needed to learn Chinese and to undertake research in a field that was, then, fairly new to me. His criticisms of early drafts saved me from still further errors. Though initially skeptical of my basic thesis, Rick has nevertheless been an unflagging supporter over the years, and for this I owe him a great debt. Nancy Holmstrom, my comrade and wife, has not only tolerated the demands my language learning, research and writing schedule has imposed on our relationship, but has given this project her unstinting moral, intellectual, and material support. I just hope it was worth it.

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ABSTRACT OF THE DISSERTATION

Class Structure and Economic Development:  
The Contradictions of Market Socialism in China

by

Richard Anthony Smith

Doctor of Philosophy in History

University of California, Los Angeles, 1989

Professor Robert Brenner, Co-Chair

Professor Edward A. Alpers, Co-Chair

The persistence of pervasive economic irrationality in the face of reforms designed to rationalize China's economy has posed difficult problems for market socialist theory and strategy. In the late 1970s, China's pragmatic leaders concluded that the key to reforming China's stultifying bureaucratic system was to be found in a broad decentralization and marketization of the economy -- within the context, crucially, of continued state planning and ownership of the major means of production. They aimed to use the market to correct the plan and especially to rationalize state industrial production. I hypothesized that this strategy was inherently contradictory and doomed, because it failed to take into account the requirements of bureaucratic reproduction. Since the

ruling bureaucracy does not own the economy privately as capitalists, but collectively through their ownership of the state, they could not really let market forces prevail without cutting themselves out of the economy. Thus, I hypothesized, the reformers would likely undermine and defeat their own reforms. I researched the effects of reforms in industry and agriculture over the decade 1978-88. I found that the attempt to enforce planning and market reforms, simultaneously, typically produced results that were the opposite of the reformers' intentions. I found no broad shift to specialization, to production for exchange, to competition-driven efficiency -- except at the periphery. Instead, managers still seek to maximize costs (inputs) not profits, they maximize wages, they invest without regard for cost (efficiency) or need (the market). Such "irrational" behavior I found to be logical within its own terms, because there still are no market penalties, because the reformers resist bringing in fundamental reforms (decontrol of labor, capital, resource allocation) which are essential to make the market work -- but which threaten bureaucratic surplus extraction and class domination. Confronted with growing irrationality, falling productivity, rising inflation and debt, the reformers postponed further reforms, and instead, recentralized the economy at the end of 1988, thus effectively abandoning their own reform project. I concluded

that, pace the theorists of market socialism, the problems of the system are systemic, intractable, and irresolvable within the existing system of property and class relations.

## INTRODUCTION

### ECONOMIC DEVELOPMENT IN POST-REVOLUTIONARY CHINA:

#### THEORY AND HISTORY

The thus far (as of May 10th) astonishingly successful, if as yet rather inchoate, revolt of China's students and workers against the party-bureaucracy has concentrated world attention on the crisis of the bureaucratic economies. The history of China's post-revolutionary economic development can be understood in terms of a tension between tendencies towards overcentralization and attempts to counteract bureaucratization through reforms from above -- first by the maoists, and most recently by the market socialists. This thesis presents a socio-historical investigation of the structural sources of economic irrationality in the Chinese economy. My perspective is critical of both the maoist and market socialist reform strategies in China and equally critical of the radical and modernizationist perspectives within U.S. China studies which may be said to broadly reflect those strategies.<sup>1</sup>

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<sup>1</sup> The literature of this debate is extensive, beginning with Benjamin Schwartz' seminal "Modernization and the maoist vision -- some reflections on Chinese Communist goals," China Quarterly, no. 21 (January-March, 1965), pp. 3-20. Other important contributions include: Stephen Andors, "Revolution and modernization: man and machine in industrializing society, the Chinese case," in Edward

It is no secret that the field of contemporary China studies has reached a theoretical impasse. Through much of the 1970s, the high ground of debate was held by a dynamic group of radical, mostly younger, new left/maoist China scholars led by Mark Selden, Stephen Andors, Edward Friedman, Victor Lippit and others who argued that the key to the most optimal pattern of economic development was to be found in the policies of the maoist leadership: mass mobi-

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Friedman & Mark Selden, eds., America's Asia (New York: Vintage, 1971), pp. 393-444; James Peck, "Revolution versus modernization and revisionism" in Victor Nee & James Peck, eds., China's Uninterrupted Revolution (New York: Pantheon, 1973), pp. 57-217; Carl Riskin, "Maoism and motivation: work incentives in China," in ibid. pp. 415-61. Martin King Whyte, "Bureaucracy and modernization in China: a Maoist critique," American Sociological Review 38.2 (April, 1973), pp. 149-63; idem., "Iron law versus mass democracy: Weber, Michels, and the maoist vision," in James Chieh Hsiang, ed., The Logic of Maoism (New York, 1974), pp. 37-61; Richard Baum, "Technology, economic organization and social change: Maoism and the Chinese industrial revolution," in B. Staiger, ed., China in the Seventies (Wiesbaden: Otto Harrossowitz, 1975), pp. 131-92; idem., "Diabolus ex machina" technological development and social change in Chinese industry," in Frederic J. Fleron, ed., Technology and Communist Culture (New York, 1977), pp. 315-56. Francis Hearn, "Rationality and bureaucracy: maoist contributions to a marxist theory of bureaucracy," Sociological Quarterly no. 19 (Winter 1978), pp. 37-54. See also those works cited in footnote no. 10 below.

I presented my own critique of the contradictions of maoism elsewhere. See my "China and the crisis of maoism," in two parts in Against the Current, Summer 1981, pp. 47-62, and Spring 1982, pp. 49-60.

lization, egalitarianism, moral incentives, class struggle and "cultural revolution." The idea was that by emphasizing the direct participation of the masses of workers and peasants in economic management the party leadership both rapidly modernize the economy through increased popular effort, and at the same time, prevent the bureaucratic/managerial layer from using its power and privilege to constitute itself as a new ruling class, like that in the Soviet Union. In the end, the realities of the Cultural Revolution delivered a stunning disproof of the maoist thesis.<sup>2</sup> A decade of "class struggle" left the economy a shambles, the masses of workers cynical and demoralized, the most conservative elements in a ponderous bureaucracy more firmly entrenched than ever, and an entire generation of youth alienated not only from maoism but also from marxism.

This outcome, needless to say, was no surprise to the

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<sup>2</sup> For some retrospective thoughts on this, see Bruce Cumings' "Introduction" to China from Mao to Deng: the Politics and Economics of Socialist Development, (Armonk, New York: M.E. Sharpe, 1983), a collection of articles from the Bulletin of Concerned Asian Scholars which present some reassessments of the Mao period by prominent new left/maoist China scholars in light of the revelations of the post-Mao era.

modernizationists.<sup>3</sup> But the question that now must be asked is, does the bankruptcy of maoism validate the perspectives of modernization theory? For the modernizationists, whose chief theorists in the field of China studies include Benjamin Schwartz, Richard Lowenthal, Doak Barnett and Barry Richman, maoism was doomed from the outset because the entire socialist project -- the creation of a classless workers democracy -- was (and is) inevitably in conflict with the "needs of modern industrial society." Industrialization, so this argument goes, under whatever political regime, must entail more extensive division of labor, more complex social organization, and the replacement of traditional socio-political barriers to economic rationalization (such as arbitrary rule, patrimonial office, etc.) by strictly impersonal, formalized, specialized and hierarchical bureaucratic structures of political administration and economic organization. It was the elimination of all traditional (e.g. feudal) constraints on the free mobility of capital and labor, and the depersonalization of political office that,

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<sup>3</sup> For some representative comments along this line, see Chalmers Johnson, "What's wrong with Chinese political studies?," Asian Survey, October 1982, pp. 919-33; and two articles by Harry Harding: "From China, with disdain: new trends in the study of China," in Asian Survey, October 1982, pp. 936-58," and "Reappraising the Cultural Revolution," in the Wilson Quarterly, Autumn 1980, pp. 132-41.

in Max Weber's view, opened the way to economic rationalization -- to the "methodical attainment of a definitely given and practical end by means of an increasingly precise calculation of adequate means."<sup>4</sup> Such precise calculability depended on the "machine-like" functioning of administrators, managers and producers carrying out their duties with stipulated rules, with strictly delimited authority, and in direct obedience to command from above. Such a "rational-bureaucratic" mode of organization must therefore be founded upon inequality: division of labor, specialized training and competence, unequal knowledge, hierarchical subordination -- all facilitate economic rationalization but rule out egalitarianism. By this reasoning, socialism as marxists have conceived it, is hopelessly utopian. Since socialism presupposes a development of productive forces at least equal to if not superior to capitalism, it must therefore, according to Weber, be still more bureaucratic.<sup>5</sup> Hence all revolutions must in the end give way to the "immutable

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<sup>4</sup> From Max Weber: Essays in Sociology, H.H. Gerth & C. Wright Mills, eds. and trans. (New York: Oxford University Press, 1958), p. 293.

<sup>5</sup> Max Weber, Economy and Society 2 vols., Guenther Roth and Claus Wittich, eds., (Berkeley: University of California Press, 1978), pp. 223-25.



limitations of human nature" and the "rational imperatives" of economic development.<sup>6</sup>

The modernizationist school has long maintained therefore that the greatest potential for economic development and social progress in China lies in the adoption of "pragmatic" policies, by which they mean: reliance on the discipline of the market, the restoration of professional bureaucracy, the implementation of scientific management and rewards tied to performance, and the introduction of science and technology from the West. Writing a full decade before the introduction market reforms in China, UCLA Professor of Management Barry Richman spoke for the mainstream majority when he remarked that "China's destiny -- industrial, economic and even military -- and the degree of fulfillment of her potential depend, in my opinion, chiefly on whether ideological extremism prevails or whether managerial, technical, and economic rationality becomes dominant."<sup>7</sup> This consensus was the basis for the

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<sup>6</sup> See especially, Richard Lowenthal, "Development vs. utopia in communist policy" in Change in Communist Systems, Chalmers Johnson, ed., (Stanford: Stanford University Press, 1970) pp. 33-116, esp. pp. 40ff; Barry Richman, Industrial Society in Communist China, (New York: Random House, 1969), chaps. 1 & 13; A. Doak Barnett, China After Mao, (Princeton: Princeton University Press, 1967), chaps. 1-3.

<sup>7</sup> Industrial Society, p. 913.

optimistic expectations of the modernizationists upon the assumption to power of Deng Xiaoping in 1977-78.<sup>8</sup>

This majority view soon become near unanimous, as most of what had been the left wing of the China field recanted and joined the mainstream. Chastened by the revelations of the post-Mao years, Friedman, Selden, Lippit and others renounced their once-held maoist views as naïve and ill-founded, and embraced the purported "realism" of the modernizationist approach they once disdained.<sup>9</sup> While most of these scholars still identify with the socialist project in China, today they say, the road to socialism in China is to be found through economics instead of politics. In an introduction to one of the

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<sup>8</sup> As expressed for example by many of the contributors to Chinese Economy Post-Mao, Joint Economic Committee of Congress, 2 vols., (Washington D.C.: U.S. Government Printing Office, 1978), vol. 1; and John K. Fairbank, "The New Two-China Problem," New York Review of Books, March 8, 1979, pp. 3-6.

<sup>9</sup> Writing in 1982, Mark Selden conceded that: "My own work underestimated the centrality of the interrelated issues of production, accumulation, and income distribution. I would also cite the work of such informed observers writing in the 1960s and 1970s as Jack Gray, John Gurley, Neville Maxwell, James Peck, and Joan Robinson, and much of the writing on the Cultural Revolution which appeared in the Bulletin of Concerned Asian Scholars and Modern China." The Transition to Socialism in China, Mark Selden and Victor Lippit, eds., (Armonk, New York: M.E. Sharpe, 1982), p.87 note 2.

several collections of essays reflecting what has been called the "new wisdom" of the post-Mao era in U.S. China studies, Professors Selden and Lippit wrote that:<sup>10</sup>

The market, then, appears as a necessary but dangerously volatile instrument in the socialist transition. . . . Several of the essays in this volume suggest that the market must play a significant role in the transition process to increase economic efficiency, realize socialism's inherent potential for material prosperity, check bureaucratic power and extend the scope for initiative and responsibility among the immediate producers.

In crediting the market not only with the potential for economic rationalization but also popular political empowerment, Selden and Lippit also seconded the modernizationist proposition that marketization is essentially supportive of, if not actually determining of democratization. Their colleague, University of Wisconsin Professor Edward Friedman asserted in 1983 that having suffered under Mao's tyranny, these "post-Mao democratizers" turned over a new leaf and "dedicated them-

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<sup>10</sup> Ibid., p. 29. Similar views are expressed in: Cummings, op. cit.; Jack Gray, ed., China's New Development Strategy (New York: Academic Press, 1982); Neville Maxwell & Bruce McFarlane, eds., China's Changed Road to Development (Oxford: Pergamon Press, 1984), Stephan Feuchtwang and Athar Hussain, The Chinese Economic Reforms (New York: St. Martin's Press 1983); Victor Lippit, The Economic Development of China (Armonk, New York: M.E. Sharpe, 1987); and in Mark Selden's most recent book, The Political Economy of Chinese Socialism, (Armonk, New York: M.E. Sharpe, 1988).

selves to liberty." According to Friedman, "there can be no doubt that [their] deep identification with . . . law, rights, constitutionality, due process and checking abuses of power is genuine."<sup>11</sup> Few sinologists went so far as Friedman in this respect, but there is no doubt that most Western China experts expected Deng to promote serious political liberalization, if not democratization.

By the early 1980s, then, the pragmatic-modernizationist-market perspective had attained a position of confident hegemony in the China field.

To be sure, the market socialist strategy has had a powerful common sense appeal, especially compared with what passed for economic policy under the maoists. If one assumes that the essential market dynamic of capitalism could be reproduced in, or grafted onto a structurally quite different, bureaucratic, economy and that it would enforce the same "economic rationality" as under capitalism, then indeed market forces will seem attractive as a means of reforming the bureaucratic system -- if not actually transforming it in the direction of capitalism (the implicit objective of the World Bank and some academic modernizationists). On the other hand, if one

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<sup>11</sup> "The original Chinese revolution remains in power," in Bruce Cummings, op. cit., p. 26.

believes -- with Selden and Lippit -- that China's bureaucratic economy is in some sense "socialist," then market reforms appear doubly attractive, since it then seems that China could have the best of both worlds: large-scale central planning and income leveling combined with competition-induced efficiency and market rationality. But the big question was (and remains), can a bureaucratic economy be made to behave like a market economy? Can competition, specialization, etc., be reproduced in the absence of private property, in an economy where the state retains near monopoly ownership of the industrial means of production and the surpluses accruing from industrial production? Market socialists of both conservative and radical persuasion certainly thought so. They also thought that the supposedly "realistic" and "non-ideological" modernizationist paradigm would serve as a more accurate guide to predicting the actual course of economic development in China than the maoist model it displaced.

As we shall detail in subsequent chapters, Deng's pragmatists "got down to business," put the experts, managers, and professionals in command and turned to the West for technical and economic assistance. They broke up the country's collective agriculture and reinstituted family farming. They dismantled much of the central control over budget allocations, taxation, and investment, turning

over control of investment decisions, wages and bonuses to the enterprises and localities. They introduced material incentives and imposed strict hierarchical responsibility under "one man management" in industry. They re-established professional associations to generate more empirically based planning. They brought in U.S. management training experts to spread the gospel of "entrepreneurship." They promoted "socialist competition" to cut waste and promote efficiency. They opened up the economy to trade with the West, contracted out much of China's modernization to the giant multinational corporations of the U.S., Japan and Western Europe and announced a massive export drive to pay for this industrial modernization. In the political sphere, they reformed the legal code to subordinate officials to "the rule of law" and render bureaucratic behaviour more regular and predictable. They revitalized local-level representative assemblies permitting some more or less free elections as a further check on bureaucratic abuse and even encouraged open protests and airing of grievances on "Democracy Wall" in the winter and spring of 1978-79.

#### **The Market Socialist Utopia**

And yet what happened? As we shall see, the economy did indeed "take off" -- but hardly as the pragmatists and their Western advisors expected or intended. To be sure, output registered sharp gains. Between 1978 and 1984

agricultural output surged to unprecedented levels. Light industrial output also grew rapidly in the early years of reform. Together, these gains greatly enlivened urban and rural markets and eased many of the shortages that had been the daily fare under Mao. Worker and peasant incomes also rose substantially in this period -- the first significant gains in more than two decades. But the hopes raised by these early gains soon gave way to alarm as the reforms proved incapable of overcoming longstanding fundamental problems, while at the same time, huge new contradictions emerged. First, after years of successive growth, output of the main food and industrial crops, grain and cotton, dropped precipitously 1985 and have yet to recover the levels of 1984. Portending still deeper problems with the reform strategy, industrial reform never really got off the ground. Right from the start in 1979, developments in the industrial economy and fiscal-administrative spheres daily contradicted the assumptions of the market socialist model and the predictions confidently advanced on the basis of that model both in China and the West. Decentralization transferred control of vast resources to lower levels, but contrary to expectation, this did nothing to alleviate, and in many ways only exacerbated problems of economic irrationality. Devolving economic decisionmaking power to the enterprise directors, permitting them to retain their profits for reinvestment

and bonus awards, schooling them in "scientific management," holding them responsible for profits and losses -- all this was supposed to turn them into economic maximizing, cost cutting, efficient "socialist entrepreneurs." Decentralization was supposed to foster competition for state contracts, forcing producers to specialize, cut costs, shed excess staff and employees, reinvest and innovate and modern technology to raise productivity, and drive inefficient producers out of the market -- à la the logic of capitalism.

In fact, as we shall see, in the dominant state industrial sector, nothing of the kind happened. To summarize very briefly: Freed from the straightjacket of central control, newly empowered enterprise directors and local officials seized the initiative. Production boomed -- and so did capital spending. But it did not go into raising efficiency and productivity as hoped. Instead, increasingly, new investments tended to be diverted from accumulation to consumption, especially into the construction of factory housing and collective amenities for staff and workers. Furthermore, much of what productive investment there has been has been redundant, thus worsening problems of overproduction, duplication and waste. The hope that competition would develop to drive the economy and weed out inefficient producers also proved illusory. What actually happened, as we shall see, is that instead



of driving out less efficient producers, these "socialist entrepreneurs" built huge numbers of small-scale uneconomic plants that duplicated existing production facilities and drained resources from larger more efficient plants. So instead of local control of investment leading to greater efficiency, the opposite happened -- inefficient producers drove the more efficient producers out of the market. Similarly, instead of cutting waste and shedding excess staff, they pursued a strategy of "blind expansion," maximizing investment and employment in their own units of production regardless of the requirements of efficiency and regardless of the needs of the national economy. Instead of specializing by comparative advantage and reorganizing the economy to link up to specialized producers "horizontally", enterprise directors and local officials typically set about using their retained surpluses to increase vertical integration and technological autarky, thus reinforcing enterprise and local self-sufficiency. Instead of improving quality, quantity and variety, local enterprises, more often than not, competed with each other by using their newfound autonomy to restrict the flow of commodities in or out of their bailiwicks, "blockading markets," and jacking up prices to rip off their own consumers left with no choice. Instead of tying rewards to performance, these "scientific managers" massively increased the distribution of bonuses,

"indiscriminantly" rewarding individuals and enterprises regardless of performance. Even technically bankrupt enterprises have increased bonus distributions. By the same token, just as all producers have succeeded under the reforms, none have failed. Competition was supposed to force inefficient enterprises to improve or go bankrupt, workers to perform or be fired. But in practice, however inefficient, the reformers have not permitted state enterprises to "fail," and instead, the number of enterprises running at a loss has grown in recent years. Likewise, in practice the reformers have prohibited the firing of workers, regardless of performance. And so on. The not very surprising result of all this is that industrial productivity, instead of rising, has stagnated and by some indices has actually fallen, and this has, among other important consequences, stoked inflation, undermined the strategy of export-led growth and forced the country increasingly into debt to Western bankers.

#### **From Economic Crisis to Popular Revolt**

In short, despite the substantial initial gains in output and incomes, the reforms created as many problems as they solved: First, despite a decade of intensive efforts, the reforms have utterly failed to resolve the underlying structural problems that have plagued China's economy since the 1950s, notably: bureaucratic mismanagement, resistance to innovation and specialization, slow

productivity growth despite ever growing investments, inability to shift from extensive to intensive growth, chronic problems of imbalance with a bias toward heavy industry. At the same time, the reforms themselves have added vast new problems to these in the shape of massive inflationary pressures, mounting foreign indebtedness, rampant corruption. In short, instead of the best of both worlds, the reformers ended up with the worst: neither socialism nor the market. And now, the efforts of the ruling bureaucracy to make China's masses pay for the crisis of market socialism through austerity and inflation, while the bureaucracy has fattened and enriched itself through multiple legal and illegal means has, finally, provoked the revolt from below that could have and should have been expected. If these events give cause for doubt about the thesis of market-led economic rationalization, one time "moderate" "liberal" now "hardliner" Deng Xiaoping's recent endorsement of the "Korean model" (free market + military dictatorship) and his open call for "bloodshed" and military repression of the current student-worker demonstrations, should raise some doubt about the thesis of market-led democratization, and prompt a reconsideration of the connection, if any, between capitalism or marketization, and democratization.

### **Social Theory and Historical Prediction**

It is now abundantly clear that the end results of the economic reforms set in motion in 1978, as well as their ultimate political impact were all but entirely unforeseen by China's reformers, by Western China experts, and by Western advocates of market reform like those at the World Bank. The failure of market socialist theorists to predict these anomalous results and to explain why the reforms have failed, to my mind raises grave doubts about the premises and logic of their theory. Yet in conventional academic and journalistic discourse, the failure of reform is still explained largely in terms of the resistance to reform by "conservative" forces, mainly within the bureaucracy. I will try to demonstrate that that this perspective is inadequate, to start with, because it fails to grasp the central fact that in China the most "radical reformers" (notably, Zhao Ziyang) have systematically subverted and arrested their own reform project, by refusing to carry through with marketization of the industrial or even fully, the agricultural economy. I will try to show that the reformers have been compelled to do so (even despite their stated intentions to the contrary) because the structure of bureaucratic property relations is such that it is essential and necessary for them to reinforce the system of bureaucratic surplus extraction (via the bureaucratic plan) in order to

guarantee their continued dominance and reproduction as members of the ruling class -- and this gets in the way of their parallel efforts to introduce market reforms. To put it another way, it will be the central argument of this thesis that the market reform strategy has been hopelessly contradictory and doomed to failure from the outset, because the theory of market socialism is fundamentally misconceived, self-contradictory, and utopian.

Whereas, as we shall see, market socialist theorists have insisted that the specific "property form" is irrelevant to the "operation" of the economy, viz. that a market dynamic and capitalist norms of economic behaviour could be reproduced in China despite the absence of private property in the major means of production and the social surplus, it will be my contention that it is precisely the specific property form (or what I shall call surplus extraction relations) that fundamentally determines the behaviour of economic agents. To put it somewhat differently, it will be my contention that the maoist and market socialist reform strategies have failed for analogous reasons: Maoism failed because the maoists attempted to impose advanced "socialist" norms in the context of a bureaucratic-exploitative system in which the ruling bureaucracy still retained a monopoly of political, economic, and social power. Market socialism is failing because the market socialist reformers wish to impose a

market dynamic while, also, retaining their monopoly of power and wealth -- a monopoly that can only be guaranteed by enforcing the bureaucratic Plan. Thus I will contend that the massive problems and contradictions that China's market socialist reformers have run into were inevitable, largely predictable, and most importantly, are ultimately irresolvable within the framework of the existing social/class system.

An important concern of this thesis, therefore, is to present evidence to document, in as comprehensive and systematic a fashion as possible, the results of the reforms in industry and agriculture -- in light of the expectations of the reform model. Beyond this, a second and more important objective of this work is to explain why the reforms, especially in industry, failed to induce a shift toward a market dynamic and market rationality. Finally, and most importantly, I will try to show that if we are to fully comprehend the real history of China's economic development both before and since the reforms, and if we are to more accurately anticipate future developments, including the potentials and limits of reforms, it will be necessary to construct a more adequate interpretive model, based in a broader social theory, the central elements of which, I shall attempt to elaborate in the last chapter.

### Plan of the Work

Chapter one will present, first, a historical overview of the socio-political and economic crisis of the mid-seventies at the close of the Mao era, which gave rise to the reforms. Secondly, it will present a summary of the industrial, agricultural and fiscal reforms (most of which were introduced in the years 1978-79) and the rationales behind them. Chapter two will analyze the results of the reforms in the rural economy between 1978 and 1988. This will focus mainly on the agricultural sector and discuss the potentials and problems these results pose for future agricultural development. It will also summarize the important developments in rural industrialization since the reforms, and the implications these hold for the reform project. Chapter three will present a comprehensive and systematic analysis of the results of reform in the industrial economy over the period 1978-88. This chapter is primarily based on my own research in government documents, statistical compendia, journal articles, and newspaper reportage. But in the most recent draft, I have been able round out this picture by incorporating material from recently completed individual and multi-enterprise studies carried out by Chinese and American scholars, notably the Chinese Academy of Social Sciences and the World Bank. The aim is to show precisely how and to what extent the reforms affected productivity and growth, altered invest-

ment and incomes policies, promoted or retarded competition, innovation, specialization, and economic (market) discipline. Chapter four will present an overview and analysis of the political-economic roots of the massive spread of corruption that has become such a prominent feature of the reform period. Chapter five is interpretative and has two essential aims. First, starting from a review of the the overall results of the reforms in light of the theoretical presuppositions of market socialist theory, it advances a critique of the conventional view that reform is being held up by conservative elements in the bureaucracy, and instead, attempts to demonstrate that reforms are resisted by all elements in the bureaucracy, reformers and conservatives alike, because true market reforms conflict with the requirements of bureaucratic reproduction. Secondly, the chapter aims to present, in rudimentary form, a theory of the dynamics of what will here be termed the bureaucratic mode of production to explain (a) why China's post-revolutionary economic development has assumed a rather specific pattern and trajectory (characterized by broad tendencies toward extensive rather than intensive growth, by slow productivity growth, by autarky and lack of division of labor, etc.) -- a pattern that is essentially similar to the developmental patterns of other bureaucratic economies but dissimilar from capitalism, and (b) why this characteristic pattern of



development has been so consistent under both Mao and Deng, why it has proven so resilient and impervious to either maoist or market socialist reforms, and why the reformers are likely to continue to resist reform.

## CHAPTER 1

### FROM MAOISM TO MARKET SOCIALISM:

#### THE CAPITALIST ROAD TO MODERNIZATION: 1978-79

In his extraordinary report to the Fifth National People's Congress in February 1978, Premier Hua Guofeng, declared that the disastrous policies of the Gang of Four had plunged the economy into such "stagnation or even decline and retrogression" that by 1976 "the whole economy was on the brink of collapse."<sup>1</sup>

#### I. THE ECONOMIC LEGACY OF THE MAO PERIOD

On the face of it, such a stark assessment seemed scarcely justified by the record. After all, since 1949 China's economy had grown at an exceptionally fast rate by any standard. Between 1950 and 1977, the gross value of industrial and agricultural output (GVIAO) grew at an average annual rate of 10.2%. This was, by comparison, roughly three times India's rate of growth for the same

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<sup>1</sup> Hua Guofeng, "Report to the First Session of the Fifth National People's Congress," (February 26, 1978), in Documents of the First Session of the Fifth National Peoples Congress of the People's Republic of China, (Beijing: Foreign Languages Press, 1978), pp. 14, 17.

period.<sup>2</sup> Even excluding the years of rapid post-war economic recovery from 1950-52, China's economy still grew at the very fast rate of 8.9%. Moreover, this long-term average rate was actually surpassed during what the post-Mao regime called the "ten lost years" (1966-76) of the Cultural Revolution when the economy grew at an average annual rate of 9.5%. China's industrial growth rate was even more impressive -- and not only by third world standards. It exceeded that of all the major industrial economies. Between 1949 and 1981 the output value of China's industry grew at an average annual rate of 12.9%. This compares with 12.4% for Japan, 9.8% for the Soviet Union, 6.9% for West Germany, and 4.5% for the United States.<sup>3</sup>

Moreover, from a country with hardly an industrial base to speak of in 1949, and most of that concentrated in a few coastal enclaves, by the time of Mao's death in 1976 China had developed into a significant industrial power. Between 1949 and 1975 industrial output increased 23 fold, the gross value of industrial and agricultural output

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<sup>2</sup> China's GVIAO figures are derived from table 2.1 below.

<sup>3</sup> Zhongguo Shehui Kexue (Social Sciences in China), no. 4, 1980, p. 4.

increased 9.6 fold. National income increased by 7 fold -- this while population less than doubled in the same period.<sup>4</sup> In 1979 China ranked first in the output of cotton yarn, third in the output of coal, fifth in steel output, seventh in power output, ninth in oil production and had become an oil exporter.<sup>5</sup> Whole industries such as petrochemicals, electronics, atomic energy, aeronautical and space technologies had been developed almost or entirely from scratch, and complete industrial systems (wanzheng di gongye tixi) were constructed in China's interior regions where there had been virtually no industry before the revolution. And most of these projects -- among them the great Daqing oil field whose 1 million barrel per day output equals one-seventh of all the oil pumped from wells in the United States -- were built during Mao's sway and according to his philosophy of zili gengsheng, or self-reliance.<sup>6</sup> Finally, in striking con-

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<sup>4</sup> Derived from "Main Indicators of China's National Economy 1949-79" in Almanac of China's Economy 1981 edited by Xue Mugiao et al. (Hong Kong: Modern Cultural Company Ltd., 1982), p. 960. Population was listed as 541 million in 1949 and 919 million in 1975.

<sup>5</sup> Beijing Review, August 17, 1981, p. 21.

<sup>6</sup> For an interesting account of the construction of Daqing in this heroic period of Maoist socialist construction from the perspective of a sympathetic oil worker specialist and participant, see the biographical vignette of the "Oil Man" in Michael Frolic, Mao's People, (Cambridge: Harvard University Press, 1980), pp. 58-70.

trast to most other developing countries, China had accomplished this substantial industrialization without sinking into foreign debt and without creating massive urban unemployment and poverty. By some measures at least, the Mao period chalked up an impressive record of accomplishment.

**Table 1.1: Gross Value of Industrial and Agricultural Output (GVIAO) 1950-78**

Year	Rate of Growth (% change per year)	Year	Rate of Growth (% change per year)
1950	23.4	1965	20.4
1951	19.0	1966	17.3
1952	20.9	1967	-9.6
1953	14.4	1968	-4.2
1954	9.5	1969	23.8
1955	6.6	1970	25.7
1956	16.5	1971	12.2
1957	7.9	1972	4.5
1958	32.2	1973	9.2
1959	19.5	1974	1.4
1960	5.4	1975	11.9
1961	-30.9	1976	1.7
1962	-10.1	1977	10.7
1963	9.5	1978	12.8
1964	17.5		

Source: Beijing Review, no. 9, February 28, 1983, p. 13

**Table 1.2: Gross Value of Industrial and Agricultural Output by Five-Year Plans**

	Agriculture (% per year)	Industry (% per year)
1949-52 Recovery	14.1	34.8
1953-57 First Five-Year Plan	4.5	18.0
1958-62 Second Five-Year Plan	-4.3	3.8
1963-65	11.1	17.9
1966-70 Third Five-Year Plan	3.9	11.7
1971-75 Fourth Five-Year Plan	4.0	9.1

Source: Ma Hong, New Strategy for China's Economy (Beijing: New World Press, 1983), p. 20

### **"Ten Lost Years"**

Nevertheless, the new leadership had due cause for alarm. For while the combined growth rates for agricultural and industrial output had on the whole been comparatively high, both the rate of growth in output and the rate of productivity increase were declining.

Agricultural performance was particularly deplorable. Between 1953 and 1976 grain output at best barely kept pace with the growth of the population. Chinese economists have conceded that between 1957 and 1978 there was "very little increase in per capita output of agricultural products" and even absolute declines in some products. Grain output per capita in 1957 was 306 kilograms and 318 in 1978. Cotton output fell from 2.57 kilograms per capita in 1957 to 2.26 in 1978. Oil-bearing crops fell from 6.58

kilograms in 1957 to 5.45 in 1978.<sup>7</sup> Whereas in the early 1950s China had been a net exporter of grain, after the collapse of the Great Leap Forward, the government was forced regularly to import grain. Between 1957 and 1976, agricultural productivity measured in terms of output per man-day declined by at least 15% and possibly by as much as 36%.<sup>8</sup> China had managed to achieve yearly increases in total output only by channeling the bulk of its population increase into agricultural labor and by increasing the number of required workdays per year from some 190 in the 1950's to between 250 and 300 by the mid-seventies.<sup>9</sup> Meanwhile, peasant incomes fared little better. Between 1965 and 1977, peasant incomes from collective sources rose by only one-half of 1% per year. In the same period, Cultural Revolution constraints on private marketing activities and

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<sup>7</sup> Ma Hong, New Strategy, p. 24. These are generally in line with Western estimates, although some Western analysts found a decline in per capita output in grain also, from the previous high of 297 kilograms in 1956 to 286 in 1977. See Arthur G. Ashbrook, Jr., "China: Economic modernization and long-term performance," in Joint Economic Committee of Congress (hereafter J.E.C.), China Under the Four Modernizations, 2 vols., (Washington, D.C.: U.S. Government Printing Office, 1982), vol. 1, p. 104, table 2.

<sup>8</sup> Thomas G. Rawski, Economic Growth and Employment in China, (Oxford: Oxford University Press, 1979), p. 119.

<sup>9</sup> Ibid., p. 13.

reductions (in some places elimination) of private plots curtailed income from rural household sideline activities. By 1977-78 rural real income was at best only slightly above the level of 1956-57.<sup>10</sup> In 1978 the government admitted that average per capita grain production in 1977 was still no greater than in 1955, that some 200 million peasants were living in a state of "semi-starvation," and that industrial workers did not receive enough rations to sustain hard labor.<sup>11</sup> Falling agricultural productivity combined with rising population forced the government sharply to step up imports of food grains (to 7 million metric tons in 1977). This in turn cut deeply into China's foreign exchange earnings and forced curtailment of imports of modern plant, machinery and equipment begun in the wake of Nixon's visit in 1972.

Declining agricultural performance was paralleled by decelerating growth rates for industrial output and industrial productivity, especially over the last decade of Mao's life. (See Tables 1.3 and 1.4). Whereas China devoted less than 25% of its national income to accumula-

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<sup>10</sup> Nicolas R. Lardy, Agriculture in China's Modern Economic Development (Cambridge: Cambridge University Press, 1983), pp. 157-63.

<sup>11</sup> Renmin Ribao (People's Daily), October 6, 1978.



tion under the First Five-Year Plan, this figure reached an excruciating 43.8% at the height of the Great Leap Forward, and, after dropping in the early sixties, climbed again to around 33% during the period 1970-78.<sup>12</sup> Yet, despite this extraordinarily high rate of investment, the rate of industrial growth had fallen by the mid-seventies to about half the long-term rate of 12% that had been achieved between 1952 and 1973.<sup>13</sup> On average, between 1952 and 1979, industrial output grew by 11.3% per year. But in the same period, the number of industrial workers increased by an average 7.1% per year. Industrial productivity, in terms of output per worker per year, increased an annual average of 3.9% between 1952 and 1979. But in the same period, capital (fixed assets) per worker grew by an average of 4.9% (the accumulated value of fixed assets installed grew by 12.4% per year). The rapid increase in fixed assets meant that the capital/labor ratio rose substantially in each period except 1965-75 -- when the growth of fixed assets fell and the growth of workers was high in relation to output -- and nearly quadrupled since

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<sup>12</sup> Beijing Review, December 21, 1979, p. 10; May 5, 1980, p. 7.

<sup>13</sup> Nicolas R. Lardy, "Recent Chinese economic performance and prospects for the ten-year plan," in Chinese Economy Post-Mao, vol. 1, p. 51.

1952.<sup>14</sup> But labor productivity, measured in terms of output per 1,000 yuan of fixed assets, fell from 1,337 yuan in 1952 to 980 yuan in 1965 and 1,051 in 1975. Thus, the growth in industrial productivity (output per worker per year) was much more the result of greater inputs of capital than increases in labor efficiency. The declining efficiency of capital was apparent in other indices as well. Whereas under the First Five-Year Plan the investment needed to increase national income by one yuan was 1.68 yuan, under the Fourth Five-Year Plan it was 3.76 yuan, an increase of more than 100%.<sup>15</sup> The same trend was manifested by the fall in state income from state-owned enterprises. Between 1957 and 1976 profits realized per hundred yuan of fixed assets in state-owned industry fell by 48.8%, from 23.6 to 1957 to 12.1 yuan. Profits and taxes realized per hundred yuan of funds also declined by 45% from 34.7 yuan to 19.3 yuan in 1976.<sup>16</sup> Economists noted that construction costs increased several fold in the same period, and the time period for completing con-

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<sup>14</sup> Robert Michael Field, "Growth and structural change in Chinese industry," in China Under the Four Modernizations, vol. 1, pp. 317-18.

<sup>15</sup> Ma Hong, New Strategy, pp. 20-21.

<sup>16</sup> Ibid., pp. 20-21.

struction projects lengthened considerably.<sup>17</sup> Furthermore, despite a quarter century of economic development and industrialization, worker incomes remained depressed. Between 1957 and 1978, the average wages of workers and staff in state-owned industry increased from 637 to 644 yuan -- an increase of just over 1% in 21 years. But since the cost of living index rose by 14.3% in the same period, real wages declined by 11.5%.<sup>18</sup>

Table 1.3: Rate of Growth in Industrial Output 1965-77

Year	Gross Value (billion 1957 yuan)	Annual percentage change
1965	139.3	---
1966	175.9	26.3
1967	147.2	-16.3
1968	154.7	5.1
1969	197.3	27.5
1970	242.3	22.8
1971	267.5	10.5
1972	295.4	10.4
1973	326.0	10.3
1974	340.6	4.5
1975	374.3	9.9
1976	382.7	2.2
1977	436.3	14.0

Source: Robert Michael Field, Kathleen M. McGlynn, and William B. Abnett, "Political conflict and industrial growth in China: 1965-1977," in J.E.C., Chinese Economy Post-Mao, vol. 1, p. 242, table 1.

<sup>17</sup> Ibid., pp. 20-21.

<sup>18</sup> Ibid., p. 22.

**Table 1.4: Growth in Industrial Output in Relation to Growth of the Labor Force and Fixed Assets**

Year	GVIO (million 1970 yuan) & staff	Average annual number of workers price (1,000)	Fixed at original purchase price (million yuan)	GVIO per worker & per staff (yuan)	Output & per yuan of fixed assets (yuan)	Fixed assets per worker & staff
1952	19,954	4,789	14,920	4,167	1,337	3,115
1957	46,544	7,346	33,660	6,336	1,383	4,582
1965	101,892	11,393	104,000	8,943	980	9,128
1975	255,154	25,531	242,830	9,994	1,051	9,511
1979	357,040	30,283	246,670	11,790	1,031	11,448

Rate of growth (percent):

1952-79	11.3	7.1	12.4	3.9	-1.0	4.9
1952-57	18.5	8.9	17.7	8.7	0.7	8.0
1957-65	10.3	5.6	15.1	4.4	-4.2	7.1
1965-75	9.6	8.4	8.8	1.1	0.7	0.4
1975-79	8.8	4.4	9.3	4.2	-0.5	4.7

Source: Robert Michael Field, "Growth and structural change in Chinese industry 1952-79," in China Under the Four Modernizations, vol. 1, p. 317.

In sum, with falling labor and capital productivity, it is evident that China's impressive industrial growth rate over the pre-reform period had been achieved only by brute force -- holding incomes down (to sustain a high rate of accumulation) and pouring in ever greater amounts of capital and labor, rather than by increasing factor

productivity.<sup>19</sup> Looking back, the economist Xue Muqiao remarked that "In the past 20 years, the ups and downs in production have resulted in ten people doing the work of three, and labour productivity has lagged further behind that in capitalist countries. Six times more workers are needed in light industry and 11 times more in heavy industry to produce the same quantities of goods as in developed capitalist countries. If things go on like this there will be no modernization."<sup>20</sup> In short, by the mid-seventies, if China's economy was perhaps not quite at the brink of collapse, nevertheless, the Maoist strategy of development by means of "high speed, high accumulation, low efficiency and low consumption" had plunged it into its deepest crisis since the Great Leap Forward, and the Communist Party's credibility was challenged as never

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<sup>19</sup> Field, "Growth and structural change," p. 318. The Chinese economist Ma Hong remarked that "The increase of total output value and financial revenues mainly depended upon pouring large amounts of funds and energy into the expansion of construction and on setting up new factories." "A preliminary discourse on a new strategy for China's economic development," Guangming Ribao (Enlightenment Daily), October 4, 1981, p. 3, FBIS October 26, 1981, p. K2.

<sup>20</sup> Xue Muqiao, China's Socialist Economy, (Beijing: Foreign Languages Press, 1981), p. 201.

before.<sup>21</sup>

## **II. THE DEEPENING SOCIAL AND POLITICAL CRISIS OF THE MID-SEVENTIES**

Compounding its troubles with the economy, the party faced a political crisis of growing proportions. Though difficult to quantify, there is little doubt that falling growth rates of output and productivity in the late Mao period were closely bound up with the disillusionment and cynicism among all sections of society, as a consequence of the general political degeneration in the aftermath of the Cultural Revolution. The mindless political campaigns, the senseless persecutions, the transparent hypocrisy, the incapacity of the leadership to maintain a consistent policy two years running destroyed what little was left of the party's credibility in the years of Mao's decline -- especially in the eyes of those born after the revolution.

**"The Communist Party regulated everything  
but would not regulate the Communist Party"**

--Liu Binyan

By the mid-seventies, the steady collapse of morale and discipline at every level of the ruling party-army-bureaucracy in the face of Mao's growing enfeeblement, had reached such a state that the leadership felt compelled to

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<sup>21</sup> The quote is from Ma Hong, op. cit., p. 26.

sound the alarm. "In recent years," Deng Xiaoping remarked in a speech to the Military Commission of the Party in 1975, "a big new problem has appeared in our army, namely factionalism."<sup>22</sup>

Formerly, organizational discipline in the army was very strong; once an order was issued, it was carried out unquestioningly. This is not the case today. Not only individuals but even some units disobey orders. For organizational discipline is related to factionalism. Their concern is not with the interests of the revolutionary body as a whole, but rather with the interests of their own clique and individual interests. The interests of a small faction transcend everything else. They want fame, fortune, and position, and if they are not satisfied, they are unhappy and even refuse to be transferred. Nowadays it is no easy matter to transfer a person. . . . Some people have turned to a bourgeois way of life and the traditional workstyle of arduous struggle has been lost. . . . [They] seek enjoyment, pay and emoluments, with everything moving up to a higher level, and the larger the number of homes they have the better. Some make no distinction between public and the private; they draw no dividing line. Some military units entertain guests and send presents; they construct multi-story buildings, halls, and places of entertainment. The army goes in for luxury, doing many things that contravene policies. So people take things at will from local jurisdictions or buy them at a low price. Some take things without going through any procedure whatsoever.

If factionalism, the disintegration of discipline, the spread of corruption, arrogance, and indolence had reached this extent in the army -- the "vanguard of the

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<sup>22</sup> Deng Xiaoping Wenxuan (1975-1982) (Selected Works of Deng Xiaoping 1975-82), (Beijing: Renmin Chubanshe, 1983), pp. 17-19.

proletariat" in CCP parlance -- how far must the rot have permeated the civilian bureaucracy? Deng was concerned not just with the corruption itself, reprehensible as it was, but with the effect of the breakdown of discipline on production. Industrial management, Deng complained, had fallen into a stupor of inertia:<sup>23</sup>

The key to poor performance in steel production lies in problems in leadership bodies, which are weak, lax, and disorganized. . . Today there is one main problem among the cadres, and that is fear; they do not dare touch a tiger's backside. Leaders in individual sectors and individual enterprises cannot fear this and fear that. It is necessary to find some people to enter leadership bodies who do not fear being toppled as a prerequisite for Central Committee support to them . . .

In all these respects, the general collapse of morals and discipline embraced the "reds" as much as the capitalist roaders -- as Liu Binyan so well described in his trenchant piece of reportage, "People or monsters" [Ren Yao zhi jian].<sup>24</sup>

#### Li Yi Zhe 1974

A signal register of the depth of the crisis of confidence the regime faced, occurred when in November 1974,

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<sup>23</sup> "Some problems to be solved in the iron and steel industry," Deng Xiaoping Wenxuan, pp. 8-9.

<sup>24</sup> Renmin Wenxue (People's Literature), no. 9, (Beijing, 1979). See below, footnote no. 32.



four former Red Guards, Li Zhengtian, Wang Xizhe, Chen Yiyang and Guo Hongzhi ("Li Yi Zhe" for short) rocked the Party leadership by posting a 20,000 character, 67 newsprint page da zi bao (big character poster) on a wall on Beijing Road in Guangzhou (Canton) entitled "Concerning socialist democracy and the legal system." The poster created an immediate sensation and attracted huge crowds. The posters were copied, reprinted and distributed underground throughout China. Though still looking to reform rather than overthrow the system, in denouncing the growth of privileges and lawlessness among high ranking cadres, the "wind of taking the back door," the "preachings" of class struggle, the "empty politics which rewarded the lazy and punished the diligent," the "daily reading [of Mao's works and quotations] which resembled the incantation of spells," the "discussion-application [of Mao's works and thoughts] which became more and more hypocritical," as well as the "thousands of revolutionary masses and cadres [who] were slaughtered," and the "millions . . . imprisoned, put under control, and struggled against,"--Li Yi Zhe went far beyond previous far-left critiques<sup>25</sup> to indict the Maoist system as a whole, and

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<sup>25</sup> Cf. the widely read "Whither China?" authored by "a soldier" of Sheng Wu Lien (short for Hunan Provincial Proletarian Revolutionary Great Alliance Committee) in January 1968. Translations of this and the Li Yi Zhe document can be found in The Revolution is Dead, Long Live the Revolution edited by The 70's Biweekly (Hong Kong, 1976), pp. 180-200 and 251-83.

gave Westerners a glimpse of the depth of the alienation felt by China's youth, and their contempt for the ruling party.

### The 1974-75 Strikewave

By the mid-seventies industrial workers, demoralized by a decade of deteriorating living standards, accompanied by repeated campaigns against such "bourgeois rights" as overtime pay, bonuses and piecework were dragging production to a standstill.<sup>26</sup> Throughout 1974-75, growing resistance including slowdowns, absenteeism, insubordination and outright strikes were reported in the mines, steel industry and railways and in major urban industrial centers including Shanghai, Anshan, Guangzhou, Wuhan, and in Guangdong, Liaoning, Jiangxi, Heilongjiang provinces.<sup>27</sup> These culminated in what was apparently a near-general strike in the city of Hangzhou in the spring of 1975 which

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<sup>26</sup> For a good description see Linda Mathews, "China worker is no model of industry," Los Angeles Times, October 15, 1977.

<sup>27</sup> China News Analysis, nos. 577-8, August 1975 and SWB 4971/B11/8, cited in Nigel Harris, The Mandate of Heaven, (London: Quartet Books, 1978), p. 149. Harris presents the most conveniently available summary of the mid-seventies strike wave, pp. 127-30.

was finally crushed by 10,000 PLA troops and the military occupation of the factories.<sup>28</sup>

### The 1976 Tien'anmen Riots

Still more threatening, in April 1976, the mounting bitterness and frustration exploded in the most important challenge to the regime since its establishment -- the Tien'anmen riots. Not long after his death on January 8, Zhou Enlai himself came under thinly veiled attack by the maoist leadership for his advocacy of what they termed the "revisionist" Four Modernizations. For reasons which have more to do with his public personality than his politics, Zhou was popularly regarded as the single moderating force against the excesses of Mao and the Gang of Four, so the attack on him sparked a spontaneous outpouring of protest against the radicals.<sup>29</sup> In the last days of March, on the eve of the Qingming festival, wreaths commemorating Zhou began appearing in front of the Monument of the People's heroes in Tien'anmen Square in Beijing. By April 2nd the square was flooded with people and wreaths, portraits and

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<sup>28</sup> See Harris, Mandate, pp. 128-29.

<sup>29</sup> For a bracing debunking of China's éminence grise see Simon Leys, "The path of an empty boat: Zhou Enlai," in Leys' The Burning Forest: Essays on Chinese Culture and Politics (New York: Holt, Rinehart and Winston, 1983), pp. 152-8.

posters piled up fifteen meters high. In the next two days, wreaths with slogans called, among other things, for the overthrow of "the Empress Dowager" (Jiang Jing). "The wreaths," one participant wrote, "became a kind of big character poster used by the people for expressing their viewpoints on the country's political life. . . The wreaths mobilized the people. The masses in front of Tien'anmen, filled with zealous fervour, copied the words on the wreaths and made speeches. . . For the first time in these twenty-six years the people stood out to voice themselves!"<sup>30</sup>

The riots were provoked when on the night of April 4th, the the police removed the wreaths. The next day some 100,000 people gathered in the square just yards from Zhongnanhai, the closed quarter of Beijing where the top officials reside, to demand the return of the wreaths. Upon hearing that the wreaths had been put inside the Great Hall of the People, the masses rushed toward the Great Hall, only to be barred by the army. The ensuing skirmish set off a day-long riot in which police cars and stations were burned, militia barracks wrecked and numbers of demonstrators beaten to death. Similar outbreaks were

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<sup>30</sup> Hua Lin, "An account of the Tien An Men incident," in Minus 8, edited by The 70's, (Hong Kong), June-July 1976, p. 5.

reported in Hangzhou, Nanjing, Zhengzhou, Kunming and Guiying and in the provinces of Anhui and Guangxi.<sup>31</sup>

With the maoists thus effectively alienated from virtually every sector of society, it was little surprise that the Gang of Four were toppled with such ease after Mao's death in September 1976, and it was testimony to the bankruptcy of maoism that their arrest provoked the first genuinely spontaneous mass celebrations in China's post-revolutionary history.

The downfall of the Gang of Four, and Deng Xiaoping's subsequent struggle for the succession, ushered in the greatest period of cultural, political and intellectual freedom in China since before the revolution. In the brief three year space between the downfall of the Gang and Deng's ultimate consolidation of power, peasants marched in Beijing to protest the poverty of maoist agrarian policies, students and former Red Guards marched and demanded to be returned from rural exile, petitioners by the thousands from all walks of life besieged government offices seeking redress from the sufferings caused by abuses of arbitrary power, and young workers and

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<sup>31</sup> According to China News Analysis, June 4, 1976, summarizing various provincial radio broadcasts. They were confirmed in an article in Peking Review, November 24, 1978, pp. 11.

intellectuals gave voice to their pent-up resentment with demands for reform written in characters large and small on "Democracy Wall" in Beijing and in the flood of unofficial publications and the "literature of the wounded" which flourished in this period. The reform drive crested in the winter and spring of 1978-79 when Wei Jingsheng and other activists raised the demand for a "Fifth Modernization" -- democracy.<sup>32</sup>

### III. THE SOURCES OF ECONOMIC IRRATIONALITY

Thus by the late seventies, the post-Mao regime was under tremendous social and political as well as economic pressure to do something to resolve the crisis, and most immediately, to do something to get the economy going again and improve living standards. As the new leadership saw it, the sources of the economic crisis were twofold: first, the overcentralized system of economic management copied from the Soviets in the early 1950s, and secondly,

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<sup>32</sup> On the political aspects of the Democracy Movement, see The Fifth Modernization, China's Human Rights Movement 1978-79, edited by James D. Seymour (Stanfordville, New York: Human Rights Publishing Group, 1980); and Andrew J. Nathan, Chinese Democracy (New York, Alfred A. Knopf, 1985); and Crossroads Socialism by Chen Erjin, edited and translated by Robin Munro (London: Verso, 1984). For much of the best unofficial literature of the movement, see the wonderful collections edited by Professor Perry Link: People or Monsters? by Liu Binyan (Bloomington: Indiana University Press, 1983), Stubborn Weeds (Bloomington: Indian University Press, 1983), and Roses and Thorns (Berkeley: University of California Press, 1984).

the left excesses associated with Mao's efforts to surmount the problems of overcentralization.

#### **China Inc.**

The problems of overcentralization began with the nationalization of the economy in the early 1950s through which the Party sought to control the entire economy from Beijing, as if it was virtually a single enterprise, "China Incorporated." As the economist Jiang Yiwei describes it:<sup>33</sup>

The state sets targets for [the enterprises], distributes their products, assigns their personnel, allocates their equipment, takes over their profit and covers all its deficits. Although certain articles in some official documents stipulate that enterprises should enjoy a certain measure of independence and should practice independent accounting, in fact they exist only as branch organizations of one colossal enterprise -- the state. In this colossal enterprise composed of tens of thousands of enterprises owned by the whole people and distributed all over the country, the State Council is like the manager general, the Planning Commission the planning section, the Economic Commission the production section, the Capital Construction Commission the capital construction section, the General Bureau of Supplies the supply section, the General Administration of Labor the section dealing with the labor forces and wages, and the various ministries are like workshops each responsible for a particular line of products.

Nationalization gave the political leadership in Beijing exclusive power to centralize resources and concentrate

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<sup>33</sup> "Theory of an enterprise-based economy," Social Sciences in China, March 1980, pp. 57-8.

them on its own economic priorities, especially to hothouse industrialization and carry out a program of broad and relatively autarkic national economic development. But in overcentralizing all economic power, and in enforcing its own priorities against the lower levels, the leadership set up a situation in which the center could not adapt its plan to specific local conditions, nor could the localities respond to the overall needs of the national economy. The advantage of central planning, as the reformer-economist Xue Mugiao noted, is that "the state can concentrate all funds and resources on key projects . . . Its weak point is that it does not make allowance for the special needs of the localities and enterprises. Thus, the localities and enterprises cannot make rational use of their manpower, material resources and money in the light of their specific conditions."<sup>34</sup> In fact "planning" in China was very crude and severely restricted, Xue further noted: "It is impossible to include all kinds of social products in the state plan

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<sup>34</sup> "It is necessary to reform our structure of economic management," Hongqi (Red Flag), no. 8 (August 2, 1979), pp. 16-24, JPRS No. 74294, October 2, 1979, p. 28. A very incisive indictment of this system can be found in He Jianzhang, "Wo guo quanmin suoyouzhi jingji jihua guanli tizhi cunzaide wenti he gaige fangxiang" (Current problems and the direction of reform in the planning and management systems of China's state-owned economy), Jingji Yanjiu (Economic Research) no. 5 (May 20, 1979), pp. 35-45.



because there are tens . . . even hundreds of thousands of them. The number will be even greater if different specifications and varieties are counted." Consequently, "only several hundred kinds of products are placed under the direct management of the State Planning Commission. Of these, a few dozen are accurately calculated; the rest are roughly estimated and may not fully tally with the actual conditions."<sup>35</sup> So the central planning authorities could not really calculate costs, output capacities, resources and needs. The inevitable result was that acute shortages coincided with huge stockpiles of unsaleable goods, and production was entirely divorced from social need. The central leadership, unaware of needs and potentials of production/consumption units at the base, had, over the years, careened from one planning fiasco to another.

Compounding the irrationalities of centralized planning, centralized control of production and income through the "vertical" structure of ministries and departments meant that producers were responsible only to their high-ups and not to the "horizontal" needs of other producing and consuming units. This meant that there was no way to directly coordinate production between firms. This led to

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<sup>35</sup> "How can we effect planned management of the national economy?" Renmin Ribao, June 15, 1979, p. 3, FBIS June 20, 1979, p. L10.

enormous duplication and waste throughout the economy. On the one hand, every province or administrative district strove to be self-sufficient in so far as possible, because they could not depend on suppliers or markets beyond their own administrative division. On the other hand, there was further waste because of the disjunction between production and marketing. In agriculture for example, farming was the concern of the peasants, processing of agricultural products the province of industrial departments, and marketing the business of the state commercial departments. Because none of these divisions were responsible to one another, the inevitable result was that more than 10% of perishable crops such as fruit and vegetables, and freshwater fish were regularly lost to spoilage.<sup>36</sup>

#### **Labor's "Iron Ricebowl" and Management's "Big Pot"**

While the irrationalities of the system were long-standing and self-evident, production units were powerless to correct the problems even when their solution was obvious, nor were they under any pressure to do so. This was because the state guaranteed to supply the necessary inputs and purchase the output of all firms and regardless of the efficiency of individual factories (colloquially

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<sup>36</sup> Beijing Review, August 4, 1980 pp. 17-18.

termed chi da guo fan, or "eating from the same big pot") and because the state guaranteed employment to every worker regardless of individual performance (labor's "iron rice bowl" or tie fan wan). The reformer-economist Ma Hong described the "cocoon" in which the firms were wrapped as follows:<sup>37</sup>

With the production tasks of enterprises under unified state arrangement and their products under unified state distribution, enterprises have to request state permission if they want to invest or need material supplies. If their requests are not approved, they can do nothing at all. If enterprises operate at a loss, state subsidies will be provided, so that there is no economic responsibility for enterprises. Similarly, if additional personnel are needed, requests must be routed to the proper authorities. If the requests are not approved, not a single person can be employed. An enterprise cannot decide for itself that it is overstaffed. In such a case, redundant staff takes its toll in wasted manpower. Whether enterprises are run efficiently or otherwise makes no difference at all, since the workers receive the same amount of wages and bonuses. All in all, enterprises are subordinate to central or local administrative departments regarding the use of manpower, material and financial resources as well as production, supply and marketing facilities. No matter how enthusiastic the staff of enterprises are or how competent their supervisors and technicians, it is difficult for them to display their initiative and run enterprises well.

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<sup>37</sup> "Gaige jingji guanli tizhi kuoda qiye zizhuquan" (Transform the economic management system and expand the decisionmaking power of enterprises) Hongqi no. 10 (October 2, 1979), p. 53.

### **The Contradictions of Mao's Reform Strategy**

Mao tried to overcome the irrationalities of this system, essentially by abolishing the central planning apparatus, and turning over control of much of the economy to radicalized cadres, so-called "revolutionary committees," in the hope that their political commitment to maximizing economic development would overcome the problems of overcentralization. But this strategy proved no solution to the problem because Mao did not really decentralize the economy, he just transferred control from one set of bureaucrats to another. Neither workers nor managers were granted real independent power and control over production, planning or even wages and working conditions. The maoist approach of substituting moral for material incentives still subordinated the workers interests in consumption to the leadership's drive for accumulation. Thus the problems of powerlessness and alienation at the lower levels still remained as before. So the net result of industrial management by revolutionary committees was generally incompetent leadership by inexperienced politicians.<sup>38</sup> Egalitarian wages and perpetual

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<sup>38</sup> See the reformer-economist Ma Hong's critique of industrial management by party committees during the Mao period in his "Guanyu gaige qiye lingdao zhidu de tantao" (An inquiry into the reform of the leadership system in industrial enterprises)" Renmin Ribao, November 20, 1980, p. 5.

austerity effectively destroyed incentives to improve performance. Workers in their own defense used "politics" as an excuse not to work. And management, fearful of being attacked for "subordinating politics to production" was powerless to enforce discipline.<sup>39</sup> The result was high absenteeism, widespread loafing, and declining productivity. Furthermore, Mao's strategy of self-reliance cut China off from national and world markets and forced factories to produce their own machine tools thereby further squandering resources that China did not have to waste.

Likewise, Mao's agricultural strategy produced results, the post-Mao leadership finally acknowledged, that were not, after all, so much different from those of Stalin.<sup>40</sup> Collectivization and the enforced leveling

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<sup>39</sup> For a case study of how under the maoists, factories were "forbidden to establish rational rules and regulations," and the results of this practice, see the case of the Shanghai no. 5 steel plant reported in "Criticism against 'theory of productive forces' results in production decline here," Renmin Ribao, June 14, 1977, p. 2, FBIS June 22, 1977, p. E1.

<sup>40</sup> They were just more effectively covered up. The economist Sun Yefang reported in 1981 that between 1957 and 1960, the death rate more than doubled from 10.8 to 25.4 per 1,000, implying an increased mortality due to the disasters of the Great Leap Forward, of more than 9.5 million persons. See his "Jiaqiang tongji gongzuo gaige tongji zhidu" (Consolidate statistical work, reform the statistical system), in Jingji Guanli (Economic Management), no. 2, February 15, 1981, pp. 3-5. Also, see the commentary on this by Nicolas R. Lardy and Kenneth Lieberthal in Chen Yun's Strategy for China's Development: a Non-Maoist

between richer and poorer teams and brigades destroyed any incentive for peasants to maximize work points. By the mid-seventies, fields lay increasingly unattended while peasants avoided agricultural work by staffing (often overstaffing) local workshops and political committees where the work was lighter and wages higher. So peasant savings increased even as farm output fell.<sup>41</sup> Mao tried to impose local, regional and national self-sufficiency regardless of local conditions and resources. When the campaign to "take steel production as the key link" was in full swing, literally millions of mini blast furnaces were set up -- even where iron and coal deposits were not available. When the campaign to "take grain production as the key link," was in full swing, the result, as one economist noted, was uncountable waste as "pastures were destroyed, forests cleared, rivers blocked and soil became sandy and seriously eroded. The equilibrium of the whole natural ecology has been upset."<sup>42</sup> As a peasant proverb put it, Mao's agrarian policies amounted to "taking grain

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<sup>41</sup> See eg. Ross Munro, "Why China's Peasants Don't Want to Work," San Francisco Chronicle July 29, 1977.

<sup>42</sup> Xue Muqiao, China's Socialist Economy, p. 184.

as the key link and ensuring all-round destruction."<sup>43</sup>

### III. DENG'S NEW ECONOMICS: VISION AND STRATEGY 1978-79

In a series of dramatic and sweeping pronouncements from the early months of 1978, Deng's pragmatists captured world headlines as one by one Mao's policies were jettisoned and China's economy gradually rounded onto the new course. Within two years the economy underwent the greatest transformation since the Great Leap Forward, and one that in some respects, notably in foreign trade and the invitation to Western investment, went far beyond the market socialist experiments of Eastern Europe.<sup>44</sup> It was

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<sup>43</sup> Renmin Ribao, February 28, 1979.

<sup>44</sup> Harry Harding has written the first comprehensive monograph on the reforms, China's Second Revolution, Reform After Mao, (Washington D.C.: Brookings Institution, 1987). Useful summaries of the early industrial reforms can also be found among the essays collected in China's New Development Strategy, ed. by Jack Gray and Gordon White, (New York: Academic Press, 1982). See in particular, Andrew Watson, "The management of the economy: the return of the economists," Thierry Pairault, "Industrial strategy (January 1975-June 1979): in search of new policies for industrial growth," and Colina MacDougall, "Policy changes in China's foreign trade since the death of Mao, 1976-80." China's Four Modernizations: the Technological Revolution, ed. by Richard Baum is particularly strong on issues of technology acquisition and assimilation. For general background see the J.E.C., Chinese Economy Post-Mao, vol. 1. A subsequent study by the J.E.C., China Under the Four Modernizations, vol. 1, provides a sector by sector evaluation of China's economic performance from 1978 through 1981.

not until November 1978, at what is now termed the "historic Third Plenum" (of the 11th Central Committee of the Communist Party of China), that the Party officially proclaimed the new "general line" which consisted, in essence, of an eschewal of class struggle, and a turn to economic construction and modernization as the main tasks in the remaining decades of the twentieth century. But the specifics of the program, both theoretical and practical, had been spelled out in series of major policy documents released well before that date.<sup>45</sup>

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<sup>45</sup> These were: Fang Yi, "Outline National Plan for the Development of Science and Technology, Relevant Policies and Measures," (Report to the National Science Conference, March 18, 1978), Peking Review, April 7, 1978, pp. 6-14, 17. "Decisions of the Central Committee of the Communist Party of China on Some Questions Concerning the Acceleration of Industrial Development (Draft)," (July 1978) (popularly known as the "30-Point Decision on Industry," and hereafter cited as such), trans. in Almanac of China's Economy 1981, pp. 175-93. "Zhongguo gongchandang di shi yi jie zhongyang weiyuan hui di san ci quanti huiyi gongbao" (Communique of the Third Plenary Session of the 11th Central Committee of the Communist Party of China (adopted December 22, 1978) (hereafter, "Communique of the Third Plenum"), Hongqi no. 1, 1979, pp. 14-21, trans. in FBIS December 26, 1978, pp. E4-E12. "Regulations on the Work of the Rural People's Communes (Revised Draft)," (the "60 Articles") (adopted by the CCP Central Committee at the 3rd Plenum in December 1978). "Decision of the Central Committee of the Communist Party of China on Some Questions Concerning the Acceleration of Agricultural Development" (adopted by the CCP Central Committee Third Plenum in December 1978), trans. in Almanac of China's Economy 1981, pp. 161-74.



Hua Guofeng's tour d'horizon, "Report on the work of government" delivered at the First Session of the Fifth National People's Congress on February 26, 1978, presented the first comprehensive outline of the reform program, the "Four Modernizations."<sup>46</sup> This awesomely ambitious plan

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<sup>46</sup> Documents of the First Session of the Fifth National People's Congress of the People's Republic of China (Beijing: Foreign Languages Press, 1978), pp. 1-118. The new turn had already been heralded the previous year by several key events. First, the republication of Mao's "On the Ten Major Relationships" (1956) in January 1977 followed in April with the release of Volume V of the Selected Works of Mao Tse-tung. These documented Mao's support for rapid industrialization (and in particular his insistence that "the development of the productive forces" must be balanced with but not subordinated to "politics"), his stress on the need for balanced economic development and for arrangement of plan priorities in the order of agriculture, light industry and heavy industry, his calls to avoid "left" mistakes, his demand for "rational rules and regulations," and for law and order and the punishment of malefactors. (See Chung Chin, "China's road to industrialization -- notes on studying Chairman Mao's 'On the ten major relationships,'" Peking Review, April 1, 1977, pp. 12-15; and "Introducing Volume V of the 'Selected Works of Mao Tse-tung'" by the Committee for editing and publishing Chairman Mao's works, CCP Central Committee in Peking Review, April 22, 1977, 1977, pp. 15-23.). Secondly, the restoration in July of Deng Xiaoping to all his former posts including member of the Political Bureau of the Central Committee, Vice-Chairman of the CPC Central Committee, Vice-Chairman of the CPC Military Committee, Vice-Premier of the State Council, and Chief of Staff of the PLA, ("Communique of the Third Plenary Session of the CCP 10th Central Committee," July 21, 1977). Thirdly, the rehabilitation of Chen Yun, architect of China's post-revolutionary recovery and the most formidable critic of Mao's economic policies in the 1950s. Fourthly, the call to mechanize agriculture. Fifthly, the reactivation of scientific research and the Chinese Academy of Sciences after a long hiatus, and the call for a National Science Conference to be held in March 1978. And lastly, the announcement in October that 46% of China's industrial workers (and especially the lowest

aimed at nothing less than to "bring the national economy into the front ranks of the world" by the year 2000. In the crucial first stage of the plan, the 1976-85 Ten Year Plan which Hua unveiled at the Congress, the government pledged to construct some 120 major industrial complexes including 30 power stations, 10 iron and steel plants, 6 railway lines and 5 harbors. The Plan called for doubling steel output to 60 million tons and stepping up grain output from 285 million to 400 million tons. It furthermore called for "at least 85% mechanization" of agriculture, simultaneous rapid expansion of light industry and construction of advanced heavy industry, with the technological renovation of metallurgical, fuel, power and machine-building industries, with "iron and steel, coal, crude oil and electricity in the world's front ranks in terms of output," with the electrification and dieselization of rail transport, the wholesale construction of new electronics industries, communications networks, and more.

Hua's speech was a transitional piece, and as such did not fail to reaffirm the centrality of class struggle, the mass line, "learn from Dazhai," etc. But the pragmatists' strategy presented in Hua's speech was anything

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paid) would receive wage hikes of up to 20%, with another 10% of the workforce receiving smaller increases.

but maoist. Hua declared that thenceforth China would reject narrow self-reliance in favor of commercial, technical and academic exchange with the west. Moreover, China would look to technological revolution and innovation instead of ideology and "will," to power economic development. He demanded the abolition of "equalitarianism" and called for a system of payment "according to work" (anlao fenpei). He declared the era of "plain living and hard work" over with, and announced that from then on there would be further wage increases, a new emphasis on consumer goods and amenities, greater spending on social welfare, housing and public utilities, and environmental protection. Ideological incentives would give way to material incentives. Local government administration, commune and factory management by collective "revolutionary committees" would be replaced by "a system of division of responsibilities," "strict personal responsibility" and hierarchy." A closer correspondence between production and social need was to be facilitated by a devolution of economic decisionmaking power to lower levels in order to "stimulate the initiative of both the central and local authorities." Planning would be supplemented by greater reliance on "the law of value" to rationalize resource allocation and production efficiency. To spur the peasants to greater output, Hua promised to improve the agricultural terms of trade by raising the state purchase prices of

agricultural products and reducing the prices of manufactured goods sold to the peasantry. To enlist the support of the intellectuals (Mao's "stinking ninth category") for modernization, Hua denounced the cultural nihilism of the maoists, declared the intellectuals "part of the working class," called for the upgrading of schools and teachers, and the reinstitution of academic standards, and declared that the Party now stood forthrightly for a new era of liberalization and "socialist democracy": "We will never allow suppression of opinion, much less retaliation against those who make criticisms" Hua declared. And as a means of putting a check on corrupt, incompetent and overbearing cadres, Hua called for a vigorous law and order campaign, and the strengthening of the "socialist legal system."

Setting the stamp on Hua's controversial pronouncements, the revised Constitution adopted at the same Congress wrote the goal of "high-speed development of the productive forces" into law. It also enshrined the principle of distribution according to work, guaranteed protection of peasant private plots and household sideline economies (and income derived therefrom) against arbitrary encroachment by local cadres and the state, instituted a system of free elections to establish popular control over the various levels of people's congresses, and finally, guaranteed the "right to strike," and the right of people

"to speak out freely, air their views fully, hold big debates, and write big-character posters."

**Learn From the Capitalists!**

Hu Qiaomu, President of the Chinese Academy of Sciences, speaking to the State Council in April 1978 pressed the theoretical revisions further.<sup>47</sup> In his assessment of the weaknesses of the economy, Hu asserted that these were due to past practices which had disregarded objective economic laws, particularly the law of value (jia zhi gui lu). Reviving the arguments of anti-maoist economists, notably Sun Yefang, Hu claimed that inasmuch as China was still and would for some time to come continue production and reproduction by means of the production of commodities, adherence to the law of value must remain "an indispensable part of our economic life." This being the case, Hu asserted, China should look to those with the most experience in organizing and managing commodity economies -- the capitalists of the west. Hu urged the leadership to import western management techniques and to enforce the law of value to rationalize the

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<sup>47</sup> Hu Qiaomu, "Anzhao jingji guelu banshi jiakuai shixian sige xiandaihua," (Observe economic laws, speed up the Four Modernizations), July, 1978, published in Renmin Ribao, October 6, 1978, pp. 1-3, and translated in three parts in Peking Review, November 10, 1978, pp. 7-11, November 17, 15-22, and November 24, pp. 13-21.

economy. "In drawing up and carrying out plans, we must make use of the law of value . . . We must see to it that all enterprises . . . make strict economical use of time, constantly strive for the best possible ratio between the expenditure of labour and material . . . and economic results, practice strict business accounting, strive to lower the unit-cost of production, and raise productivity and the rate of profit. . . and see that prices correctly reflect value."<sup>48</sup>

The pragmatic leadership's new economic strategy, as implemented in the years 1978-80, embraced three interrelated components. These were: first, the introduction of market pressures to bring the plan into closer correspondence with social needs; secondly, re-bureaucratization and the revival of the central statistical services to rationalize planning and management; and thirdly, political and cultural liberalization to enlist popular support for the modernization drive.

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<sup>48</sup> Peking Review, November 17, 1978, p. 18. In an article entitled "Yao lizhi qi zhuang di zhua shehuizhuyi lirun," (It is necessary to righteously and confidently grasp socialist profit), Sun Yefang argued anew that "profit will become the comprehensive index that best expresses how enterprises are managed." Renmin Ribao, October 23, 1978, p.3. Also see Deng Xiaoping's comments along these lines in his "Why China has opened its doors," Bangkok Post, February 10, 1980 p. 5.

#### IV.A. Political and Cultural Liberalization

To revive the morale and elicit the contribution of teachers, professors, scientists and other intellectuals to the Four Modernizations, the new leadership launched a vigorous campaign to rehabilitate and upgrade the status of intellectuals, and to open a new era of cultural and political liberalization.<sup>49</sup> Deng Xiaoping himself set out to convince the skeptical by taking charge of the revitalization of science and education -- promoting conferences, speaking on behalf of scientists and educators and volunteering to help scientists secure hard-to-obtain scientific equipment.<sup>50</sup> The State Council, in October 1977, issued a directive to colleges and universities restoring academic criteria and entrance examinations for admissions and reinstituting tests and grades to measure academic performance.<sup>51</sup> Steps were taken to improve the salaries and housing of teachers and professors, and

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<sup>49</sup> See eg. Shang Wen, "Social sciences: a hundred schools of thought contend," Beijing Review, April 6, 1979 pp. 9-14.

<sup>50</sup> See in particular his speeches of August 8, 1977, September 19, 1977, March 18, 1978, March 28, 1978 and April 22, 1978, in Deng Xiaoping Wenxuan, pp. 45-55, 63-68, 82-97, 98-99, 100-107.

<sup>51</sup> Fang Yi, "On the situation in China's science and education," Peking Review, January 13, 1978, pp. 15-19.

classroom time devoted to political instruction sharply cut back. Professional titles for scientists and technicians were restored and those relegated to unsuitable (and often menial jobs) were reassigned to their original posts. In a pointed rejection of maoism, the Central Committee decreed that scientists and technical personnel were to devote "at least five-sixths of their work hours to professional work," and were henceforth to be exempt from manual labor, mandatory political study sessions, and assignment to May 7th cadre schools.<sup>52</sup>

#### **The Rehabilitation of "Capitalist Roaders"**

Following Deng's own rehabilitation, he and his faction set out to rehabilitate "rightists" from the Cultural Revolution and the Anti-Rightist campaigns in the 1950s. In all some 2.3 million cadres were rehabilitated and the pragmatic leadership restored those who were able to power in the factories and in the central, local and provincial government apparatus. Fierce factional struggle at the November-December 1978 Central Committee work conference, the 3rd Plenum, routed the maoists and culminated in the decisive victory of Deng's pragmatists. Chen Yun, the

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<sup>52</sup> Deng Xiaoping Wenxuan, pp. 82-97; Fang Yi, "On the situation in science and education," p. 17; "The 'five-sixths' rule should be applicable to all scientists and technicians," Renmin Ribao, Nov. 9, 1978, FBIS November 14, 1978, pp. E11-12.



eminent economist, Ding Yingchao, Zhou Enlai's widow, Hu Yaobang and Wang Zhen were elected additional members of the Politburo (and Chen also added as a vice chairman of the CCP Central Committee). Nine more members including Song Renqiong, Hu Qiaomu, and Wang Renzhong were also added to the CCP Central Committee. The same conference also reversed the verdicts on former Finance Minister and close associate of Liu Shaoqi, Bo Yibo, former Defence Minister and critic of Mao over the debacle of the Great Leap Forward, Marshal Peng Dehuai (the latter posthumously) and numerous other critics of Mao.<sup>53</sup>

In a dramatic bid to encourage trade, investment and joint ventures, the Central Committee in January 1979 announced that China's national bourgeoisie would have their bank deposits, high salaries, houses and other personal belongings which had been confiscated during the Cultural Revolution, restored.<sup>54</sup>

To provide work for the millions of unemployed school leavers and youth returning legally and illegally from

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<sup>53</sup> "Communique of the Third Plenum." Liu Shaoqi, however, was not rehabilitated until March 1980. See "Communique of the Fifth Plenary Session of the 11th CCP Central Committee" (adopted February 29, 1980) in Hongqi March 5, 1980 pp. 2-5, JPRS no. 75580 April 28, 1980 p. 5.

<sup>54</sup> Xinhua, January 25, 1979.

years of exile in the countryside, the government permitted the restoration of urban privately owned small businesses to provide daily necessities and services lacking in state-run stores. And to encourage entrepreneurship in the villages, the Central Committee further announced the "removal of designations" and the end of discrimination against former landlords and rich peasants and their children.<sup>55</sup>

**"Seek Truth From Facts!"**

To generate more empirically based planning data, scientific and academic societies and research institutes were reopened in 1977. Deng gave directors of China's research institutes a free hand to set their own priorities and follow scientific inquiry without party interference. Former "rightist" economists including Chen Yun, Sun Yefang, Deng Liqun and Yu Guangyuan, and Ma Yin-chiu were rehabilitated in 1978 and 1979 and their works republished.<sup>56</sup> In 1979 the State Council ordered the restoration of the State Statistical Bureau, and called for bringing the number of statisticians in departments at or above the county level back up to their pre-Cultural

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<sup>55</sup> Xinhua, January 28, 1979, FBIS January 30, 1979, p. E1.

<sup>56</sup> Xinhua, December 27, 1978; August 2, 1979; and August 15, 1979.

Revolution level (21,000).<sup>57</sup> And journals in economics and the sciences, as well as the humanities, some of which had been discontinued for a decade or more, were revived and numerous new publications founded.<sup>58</sup>

The reform leadership further hoped to rely on computerization to rationalize planning. In June 1980, The Chinese Academy of Social Sciences and the Quantitative Research Society held China's first econometrics class under an American-led teaching team.<sup>59</sup> And in July of the same year, members of the CAS Institute of Systems Science proposed to begin compiling input-output tables to plan the national economy starting in 1981. The use of mathematical methods and computerization, they argued, would "detect imbalance in sectoral proportion and output of major products," "find flaws and propose ways of improvement," "compute total labor consumption of all products, and, based on these results, offer a scientific method and

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<sup>57</sup> Sun Yefang, "Consolidate statistics work," op. cit., p. 5.

<sup>58</sup> Most notably, Jingji Yanjiu (Economic Research) resumed publication as a serious journal. And Jingji Guanli (Economic Management), Caiwu Yu Kuaiji (Financial Affairs and Accounting), Shichang Bao (Market News), Xiandaihua (Modernization) all began publication in 1979.

<sup>59</sup> Guangming Ribao, June 24, 1980 p. 3.

actual data for determining the price of each product,"  
"make economic forecasts," etc.<sup>60</sup>

#### **IV.B. The Industrial Responsibility System**

In its Communique of the Third Plenum in December 1978, the Central Committee of the Communist Party outlined its strategy for reforming the industrial structure by means of a wholesale transfer of authority downward.<sup>61</sup>

It is necessary boldly to shift it under guidance of the leadership to lower levels so that the local authorities and industrial and agricultural enterprises will have greater power of decision in management under the guidance of unified state planning; big efforts should be made to simplify bodies at various levels charged with economic administration and transfer most of their functions to such enterprises as specialized companies or complexes . . . it is necessary . . . to put a stop to the substitution of party for government and the substitution of government for enterprise administration, to institute a division of responsibilities among different levels, types of work and individuals, increase the authority and responsibility of administrative bodies and managerial personnel, reduce the number of meetings and amount of paper work to raise work efficiency, and conscientiously adopt the practices of examination, reward and punishment, promotion and demotion.

The new industrial "industrial economic responsibility system" (gongye jingji zeren zhi) aimed to

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<sup>60</sup> Xinhua, July 29, 1980, FBIS August 1, 1980 pp. L7-8.

<sup>61</sup> "Communique of the Third Plenum," p. E7.

rationalize industrial production by "vesting enterprises with great economic power internally while subjecting them to pressure externally."<sup>62</sup> The reform of the industrial system implemented in phases between 1978 and 1981, covered three interrelated aspects: First, the substitution of "economic levers" (jingji ganggan) such as prices, taxes, and bank credit, for administrative control and direction of planning, production, and distribution. This included partial dismantling of both the central allocation of investment funds as well as the system of unified purchase and supply whereby the state monopolized purchase and distribution of products. These were to be supplanted by financial "self-responsibility for profits and losses" (zifu yingkui): the enterprises were to finance capital investment, technical renovation, and economic incentives to labor and staff by retaining a portion of their profits and borrowing the rest of their needs from the banks, at interest. Secondly, the reform of enterprise management. This included "professionalizing" management by promoting better educated, more technically qualified personnel to positions of leadership, and granting greater authority to managers with respect to the production process, as well

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<sup>62</sup> Renmin Ribao, November 7, 1980, p. 5, FBIS November 26, 1980, p. L16.

as with regard to control over capital investment, marketing and imports and exports. Thirdly, the reorganization of industry: fostering greater specialization, integration, and competition.

### 1. Restoring the Authority of the Factory Director

With Hua's announcement that the revolutionary committees that had run China's factories were to be dropped, the leadership, in July 1978, reimposed the system of "one-man management" placing sole responsibility for enterprise management in the hands of the factory director.<sup>63</sup> Chief engineers, technicians, and accountants, etc. were likewise empowered to assume responsibility for technical matters.<sup>64</sup> 'A la Weber, the designation of clear-cut and hierarchical division of responsibilities, and a "strong and able chain of command" were held by Deng to be key to the reform of management.<sup>65</sup> Enterprises, depart-

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<sup>63</sup> "30 Point Decision on Industry," p. 178.

<sup>64</sup> Ibid. p. 178.

<sup>65</sup> "There must be someone responsible for every piece of work and every position. "There must be clear responsibilities for every cadre, worker, and technician." Deng Xiaoping, "On the general program of work for the whole party and the whole nation," (1975) translated by Chi Hsin in The Case of the Gang of Four (Hong Kong: Cosmos Books, 1977), p. 230. See also the State Council documents drafted under Deng's direction: "Some problems in accelerating industrial development," (known as the "Twenty Articles on Industry"), (original draft, August 22, 1975 published in Ming Bao (Hong Kong), May 20-28,

ments and work units were further instructed to set up and strengthen a "strict system of rational rules and regulations."<sup>66</sup>

## **2. Decentralizing Finance and Economic Decisionmaking**

From 1978 through the early 1980s, Beijing implemented several experimental profit sharing schemes in industry. These differed principally in the method by which revenues were divided between the enterprise and the central government.<sup>67</sup> In October 1978 the government

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1977), Working Draft of September 2, 1975 translated in The Case of the Gang of Four, pp. 247-53; and "30 Point Decision on Industry," p. 179.

<sup>66</sup> Deng Xiaoping, "On the general program," op. cit., p. 229; "30 Point Decision on Industry", op. cit., p. 179.

<sup>67</sup> The following account simplifies a rather complex history. There were at least two, and possibly as many as four distinct profit sharing schemes implemented experimentally during these years. I will here describe only the two main schemes -- the system of "profit retention" and the system of "substitution of taxation for profit remittance." For detailed discussion of all the various systems, and the pattern and timing of their introduction, see Bruce L. Reynolds, "Reform in Chinese industrial management: an empirical report," in China Under the Four Modernizations (1982) vol. 1, pp. 119-37; Martin Lockett and Craig Littler, "Trends in Chinese enterprise management, 1978-82," World Development, vol. 11, no. 8 (1983), pp. 683-704; Barry Naughton, "False starts and second wind: financial reforms in China's industrial system," in The Political Economy of Reform in Post-Mao China, Elizabeth J. Perry and Christine Wong (eds.), Cambridge, Massachusetts: Harvard University Press, 1985, pp. 223-52; and Peter Nan-shong Lee, "Enterprise autonomy policy in post-Mao China: a case study of policy-making 1978-83," The China Quarterly, no. 105 (March 1986), pp.

launched its experiment in industrial autonomy by granting six industrial enterprises in Sichuan, China's most industrialized province, the so-called "eight rights."<sup>68</sup> This was a broad program of decentralization to the enterprise level which in theory gave the firms substantially increased control over investments, planning and production, wages and personnel, and marketing. These "rights" were as follows:

1) Right to retain part of the profits after fulfilment of the main economic and technical targets set in the state plan. Initially this was set at 3-5% of profits on output of planned production, and 15-25% on sales of above-plan production. Retained profits were to be used for reinvestment to upgrade plant and equipment and expand output, to pay cash bonuses to workers and staff, and to improve collective welfare facilities for staff and workers (housing, cafeterias, educational and recreational facilities, child care, etc.).

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<sup>68</sup> State Council, "Regulations on the tentative system of enterprise funds for State enterprises," Xinhua December 19, 1978, FBIS December 27, 1978, pp. E22-24. For discussion of the background of the Sichuan model of enterprise self-management, see Lin Zili, "Initial reform in China's economic structure," Social Sciences in China, September 1980, pp. 172-94; and David Bonavia, "In economy, learn from Sichuan," Far Eastern Economic Review, November 21, 1980, pp. 30-34; and "Zhao Ziyang's 'Sichuan experience': blueprint for a nation," Chinese Law and Government, Spring 1982 (entire issue), edited by David L. Shambaugh.



- 2) Right to expand production with funds accumulated by the enterprise and to retain the profits derived from expanded reproduction in the first two years.
- 3) Right to retain 60% of the depreciation fund for fixed assets, as against 40% in the past.
- 4) Right to engage in production outside the state plan once planned targets have been met.
- 5) Right to market their own products which state commercial and materials departments do not purchase.
- 6) Right to contract with foreign governments and firms to export their products and to reserve part of the foreign exchange earnings for the import of new technology, raw and other materials and equipment.
- 7) Right to issue bonuses at the enterprises' own discretion within the range approved by the state (in 1980 not more than two months' average wages of the workers and staff).
- 8) Right to penalize those who incur heavy losses to the state, including workers, Party secretaries and factory directors, due to negligence in work or other subjective reasons. The most serious penalty was expulsion from the factory.

In July 1979, the State Council extended the new policy to 4,000 enterprises throughout the country. In the following year, the reform was extended to cover some 6,000 enterprises comprising 16% of all state-owned enterprises and accounting for 60% of output values and 70% of profits yearly under the state plan, and in January, 1981 it was extended to cover all state-owned enterprises.<sup>69</sup> Parallel with this, the state revised central -- local fiscal relations to grant provincial governments the right to retain a larger share of the industrial and commercial

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<sup>69</sup> Xinhua, September 6, 1980, FBIS September 9, 1980; Beijing Review, April 6, 1981, p. 23.

taxes -- the main source of government income.<sup>70</sup> The profit retention scheme was the first phase of a progressive decentralization which aimed to force all state-owned enterprises to assume full responsibility for their own profits and losses. This would make it possible for the state to rely "mainly on economic methods to manage the economy, such as interest rates, taxes, and prices . .

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The system of retention of a fixed percentage of profits put greater power in the hands of enterprise directors but had a number of defects, the most important of which was that it did not take into account vastly different rates of profit of different firms, even in the same line of production, owing to "objective factors" beyond the directors' control such as highly irrational prices, the availability of raw materials and labor, the condition and technical level of plant equipment, access to transport and markets, etc. Consequently, managers

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<sup>70</sup> See Audrey Donnithorne, "Fiscal relations," The China Business Review, November-December 1983, pp. 25-27.

<sup>71</sup> Li Kaixin, director of the State Bureau of Supplies and vice-chairman of the State Planning Commission, in an interview in The China Business Review, November-December 1980, p. 17.

could not yet be held fully responsible for their plants' performance or level of profitability.<sup>72</sup>

Starting in 1979, the government began to introduce a new scheme, called the system of "substituting state taxation for profit-delivery" (abbreviated as li gai shui).<sup>73</sup> This system, which was adopted nationwide in 1983, was devised to overcome the inadequacies of the various profit retention schemes. The objective of the tax-for-profit system was to compensate for unequal rates of profit determined by the above noted "objective factors" (which the state said "cannot be changed for the present") by imposing a series of differential taxes on the firms to "even out" profit rates.<sup>74</sup> It was also intended as a means to charge enterprises for the use of factors of production

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<sup>72</sup> Renmin Ribao, November 7, 1980, p. 5; Xinhua, August 19, 1980, JPRS September 2, 1980, pp. 40-1.

<sup>73</sup> For details of this system see Ma Hong, "Guanyu jingji guanli tizhi gaige de jige wenti" (Several problems in reforming the system of economic management), Jingji Yanjiu, July 1981, pp. 11-24; Lee, "Enterprise autonomy policy," pp. 53ff; Naughton, "Financial reforms," pp. 240-4; and Reynolds, "Reform in Chinese industrial management," p. 132.

<sup>74</sup> "Strengthen tax collection work and perfect the relevant system," Jingji Ribao (Economic Daily) editorial August 15, 1983, p. 1, FBIS August 22, 1983, pp. K9-10.

such as investment funds and productive inputs which were formerly supplied to the firms by the state as free grants. Under the various versions of this scheme, enterprises were to be charged a flat rate income tax (in the 1983 version this was set at 55% for large- and medium-sized firms, and calculated on a sliding scale for smaller firms), various "adjustment" and "resource" taxes to equalize profit rates, and charges were placed on fixed and circulating capital.<sup>75</sup> All profits net of taxes were to be retained by the enterprises.

In place of "costless" state allocations of fixed and circulating capital, enterprises were thenceforth to generate their own funds to pay for fixed assets, to fund production, expansion and renovation, entirely from product sales and from loans (at interest) from state "investment banks." It was argued that because enterprises would now have to repay principal plus interest due, this would "force the borrowing units to calculate more carefully and practice strict budgeting," concentrate investments in economically rational projects, shorten construction time,

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<sup>75</sup> Itemized lists of these taxes may be found in the Finance Ministry's circular of May 2, 1983 as reported by Beijing Xinhua May 2, 1983, FBIS May 5, 1983 pp. K4-8. See also Xu Yi, "On the second-stage reform in the substitution of tax payment for profit delivery," Renmin Ribao, September 10, 1984, p. 5, FBIS September 26, 1984, pp. K19-20.

improve their operation and management, cut costs, and increase profits.<sup>76</sup> Correlatively, the role of the banks (the People's Bank of China (circulation funds), the Bank of China (foreign exchange), the Agricultural Bank, the Chinese People's Construction Bank) was vastly expanded. In the past the banks had been powerless "depositories" which had no control over deposits or disbursements. They were now expected manage their deposits with the same aggressive profit maximising attention as other enterprises. It was assumed that the banks would supervise loans much more closely that the state had previously, therefore would "conduct careful investigation before granting loans, examine carefully the applications for loans and inspect construction projects after loans have been granted."<sup>77</sup> It was furthermore stipulated that "the

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<sup>76</sup> Jingji Guanli, July 25, 1979 pp. 6-10, JPRS no. 74475 October, 30, 1979 pp. 42-9; Agence France-Presse May 18, 1979, FBIS May 21, 1979 pp. L10-11; Xinhua, January 24, 1982, FBIS January 28, 1982.

<sup>77</sup> Jingji Guanli, February 15, 1979 p. 17-18, JPRS no. 73955 August 3, 1979 p. 100. To insure that borrowing enterprises "strengthened their business accounting," the state in 1980 levied hefty interest penalites on inefficient operations. The Sichuan branch of the People's Bank of China reported that "beginning this year, the banks, following state regulations have raised interest to the following rates: Overdue loans of industrial and commercial enterprises, 20%; loans in excess of the prescribed amounts of circulating funds and loans on overstocked goods, 30%; loans for funds in excess of prescribed requirements by enterprises engaging in capital construction or renovating or rebuilding work, 50%. This represents an important role in the employment of interest

state shall no longer provide enterprises with additional funds for tapping potential or launching technical innovation and transformation. In case of losses, the state shall provide no subsidies to the enterprises. Basically, an enterprise shall manage its own finances and be responsible for its own profits and losses."<sup>78</sup> "In this way," it was said, "all enterprises are [now] placed at a level whereby their gains are comparable to the subjective efforts they have exerted."<sup>79</sup>

In theory, by placing all enterprises on an equal "competitive" footing (by equalizing profit rates), by imposing charges for hitherto free inputs, by leaving the firms in possession of all after-tax profits, by eliminating guaranteed government purchase and supply, and subsidies, and by linking profits to "sales" this would both give the firms the opportunities to maximize performance

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rates as a lever to encourage enterprise units to keep more funds in their depositories, to tap hidden potentials, to reduce overstocking of goods and to use funds rationally and economically." Sichuan Ribao (Sichuan Daily), July 7, 1980 p. 2, FBIS August 5, 1980 p. Q3.

<sup>78</sup> Xinhua, November 10, 1980, FBIS November 12, 1980 p. 21.

<sup>79</sup> Xinhua August 19, 1980, JPRS No. 76338 September 2, 1980 p. 40. Xinhua, November 10, 1980, FBIS November 12, 1980 pp. L20-2.

and put pressure on them to do so. These, at any rate, were the arguments of China's leading reformer-economists such as Ma Hong and Xue Muqiao.<sup>80</sup>

### 3. Professionalizing Management

To introduce western efficiency techniques to these newly empowered factory directors, the government established several management research societies and schools for managers.<sup>81</sup> The Chinese Enterprise Management Association (CEMA) established in Beijing in March 1979 brought in western management experts to conduct courses and workshops to train management cadres at all levels.<sup>82</sup> A new journal, Jingji Guanli (Economic Management), was launched to promote "scientific management," one of its first issues

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<sup>80</sup> See for example Ma Hong, "Several problems," op. cit., pp. 11-24; and Xue Muqiao, "Zhongguo jingji tiaozheng zhong de xingshi gaige" (The current situation and reform in China's economic readjustment), Shijie Jingji Daobao (World Economic Herald), no. 35, June 1, 1981, pp. 6-8.

<sup>81</sup> The China Technical Economic Research Society and the China Management Modernization Research Society were established in Beijing in December 1978. Guangming Ribao, December 12, 1978, p. 3, FBIS December 21 1978, pp. E15-16. See also, Zhang Zhongfang and Hu Maoliang, "Grasping scientific management is a pressing matter," Jiefang Ribao (Liberation Daily), January 21 1979, p. 1, JPRS no. 73316 April 26, 1979, pp. 8-10.

<sup>82</sup> The China Business Review, July-August 1979, p. 7, and January-February 1980, pp. 8-10.

featuring a lead article on General Electric's organizational structure. And in August 1980, China opened its first business school, the National Center for Industrial Science and Technology Management Development, at Dalian, Liaoning Province. The school opened with 120 students, made up of factory managers, government officials, and university professors. They were taught Western management efficiency techniques by an American management faculty of eight headed up by Dean William Dill of New York University Business School.<sup>83</sup> By February 1982 the government claimed that more than 1.6 million leading cadres, managers and technicians had rotated through two-, three- and six-month management training courses at Dalian and similar schools. This represented 23% of China's 7 million cadres. Some 340,000 factory directors and managers representing 64% of the total number of heads of state-owned enterprises at the county level or above had completed such courses by the end of 1981.<sup>84</sup> By the end of 1984, the government claimed that younger more technically

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<sup>83</sup> Thomas H. Pyle, "Reforming Chinese management," The China Business Review, May-June 1981, pp. 7-19; "Teaching management to Marxists," Fortune, March 23, 1981, pp. 102-103. Also, Richard W. H. Lee, "Training ground for a new breed of professionals," The China Business Review, May-June 1985, pp. 39-42.

<sup>84</sup> Xinhua, October 14, 1981 and February 6, 1982.



competent directors had assumed leadership of 80% of all state-owned enterprises and commercial departments.<sup>85</sup>

Simultaneously, Deng undertook a difficult struggle to purge foot-dragging maoists and enliven the bureaucracy by retiring the aged leadership of guerrilla cadres and promoting a younger, better educated, more technically competent generation of leaders in the factories and government administration. By 1982, lifetime tenure had been formally abolished and limitations placed on all top posts.<sup>86</sup> Deng himself led the retreat, stepping back to the "second line" of leadership and urging others of his generation to follow suit, usually with the encouragement of a "golden handshake" that permitted them to retain their privileges, their spacious housing, chauffeured limousines, access to their old offices as "advisors," etc. By mid 1982, a survey showed that the number of ministries and commissions as well as departments and bureaus

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<sup>85</sup> Beijing Review, March 11, 1985, p. 17.

<sup>86</sup> The revised 1982 constitution set a maximum of two five-year terms for the PRC chairman and vice-chairman, Central Military Council chairman, premier, vice-premiers, and state councilors. New rules also set mandatory retirement ages "under normal conditions" for ministers (65), and for vice-ministers, department directors, deputies, and bureau directors (60). See Christopher M. Clarke, "China's organizational revolution," The China Business Review, July-August 1982, pp. 26-33.

within them had been reduced considerably. The average age of ministers dropped from 64 to 58, that of department and bureau heads from 59 to 54. And the percentage of college-educated ministers and vice-ministers rose from 37% to 52%, while that of department and bureau heads rose from 36% to 49%.<sup>87</sup>

#### 4. Motivating Labor

After more than a decade's hiatus, industrial trade unions were revived in the fall of 1978.<sup>88</sup> Speaking at the first trade union congress in 21 years, Deng Xiaoping noted that realizing the Four Modernizations would require "major transformations, not only in regard to technique but in regard to systems and organizations as well." He called upon the unions to both "work hard to protect the welfare of workers," and educate their members to "master modern technology and managerial skills." All our enterprises, he said, "must carry out democratic management, combining unified leadership with democratic management." "From now on," he added, "workshop directors, section chiefs and group heads in every enterprise must be elected

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<sup>87</sup> Ibid., p. 26.

<sup>88</sup> Xinhua, November 8, 1978.

by the workers in the unit." Major issues in an enterprise were to be discussed by workers' congresses or general membership meetings. Such congresses and meetings, Deng said, "have the right to suggest to higher levels that certain leading or managing personnel be punished or replaced for serious negligence of duty or for a bad style of work."<sup>89</sup>

To boost the flagging morale of a workforce attacked by the previous leadership for its "economism," the government in 1978, appropriated more funds for constructing new housing for workers and staff, and launched a nationwide campaign to put "safety first" in the factories.<sup>90</sup> For the first time, the press publicized incidents of occupational accidents, diseases, injuries and deaths in China's factories and mines. And as a warning to correct these abuses, stiff sentences were meted out to officials found guilty of negligence.<sup>91</sup>

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<sup>89</sup> Speech to the Ninth National Congress of Chinese Trade Unions in Beijing, October 11, 1978, Deng Xiaoping Wenxuan, pp. 124-9.

<sup>90</sup> "30 Point Decision on Industry," op. cit., p. 191; Xinhua December 28, 1978, FBIS January 5, 1979, pp. E25-26.

<sup>91</sup> Renmin Ribao, May 23, 1979, FBIS May 25, 1979 L11-12; Xinhua May 20, 1979, FBIS May 23, 1979, pp. L7-8.

To improve discipline, the new leadership moved to tie the incomes of staff and workers to enterprise performance by abolishing the egalitarian distribution system by which employees had been paid their wages regardless of profits or losses incurred by the plant, and replacing it with a new distribution system: "more pay for more work, less pay for less work, no pay for no work." Regular pay increases were revived, the piecework system reinstituted and expanded, bonuses were revived, and the wage spread broadened.<sup>92</sup> The profit retention system tied the bonus potential to enterprise performance and linked the interests of workers and management in maximising profitability, and therefore it was assumed, output, quality, etc. In this way it was argued that "Good economic results in the production management of enterprises will bring more material gains for the staff and workers in the enterprises. The material gains will be lessened if the

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<sup>92</sup> "30 Point Decision on Industry," op. cit., pp. 190-1; State Planning Commission, State Economic Commission and State Bureau of Labor, "Provisional Regulations Concerning Piece-rate Wages in State-owned Enterprises (draft)," (April 1, 1980), in Almanac of China's Economy 1981, pp. 277-8. Also, Wang Huibo, "Bixu ba laodongzhe di yibufen shouru he qiye de jingying" (We must closely tie part of workers incomes to enterprise managerial performance), Jingji Yanjiu no. 12, 1978, pp. 37-43.

reverse is true."<sup>93</sup>

#### 5. Competition, Innovation, Specialization and Rational Reorganization of Industry

Another goal of decentralization was to break down the traditional patterns of geographical, ministerial, departmental and enterprise vertical integration and self-sufficiency -- what the Chinese call "big and all-inclusive" and "small and all-inclusive" (da er quan, xiao er quan). In the past, every province, county and locality, every ministry, department, and enterprise strove, in so far as possible, to be self-sufficient in productive inputs (raw materials, machinery, labor), so as not to have to rely on outside suppliers. Of the total of 38 central government ministries in 1981, 14 were primarily engaged in manufacturing, including eight ministries of machine building. But practically every other ministry possessed its own industrial enterprises to supply its own special needs. The Building Materials, Chemical and Metallurgical Industry Ministries had their own mining operations. The Ministry of Textile Industry had its own petrochemical complexes to produce synthetic

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<sup>93</sup> Wang Zhenshu, "The income of staff and workers must be directly linked with the achievement of enterprise management," Jingji Guanli, June 25, 1979, pp. 18-19, JPRS August 27, 1979, p. 21.

fibers; and it also produced most of China's textile machinery. Nearly all ministries had machine-building enterprises. The Ministry of Coal Industry made coal mining machinery; the Ministry of Railways made railway equipment; the Ministry of Post and Telecommunications made telephone equipment; The Ministry of Communications built ships and other maritime transport equipment. The giant Anshan Steel complex owned its own ore mines. Etc. etc.<sup>94</sup> And nearly every enterprise possessed its own repair facilities, some of which manufactured their own machinery.

At factory level, the pattern of "small and all-inclusive" prevailed. Instead of a structure of industrial production characterized by interdependent specialist producers of components side by side with manufacturing and assembly plants, typical of capitalist production in the West (eg. integrated auto manufacturing plants which both make some of their own parts and assemble related components, such as piston rings, spark plugs, ball bearings, meters, tires, even engines, which are manufactured in huge batches at low cost by specialized suppliers), China's industrial enterprises sought to "own" their sup-

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<sup>94</sup> World Bank, China: Socialist Economic Development, World Bank Country Report, (World Bank, Washington D.C. 1983), vol. 2, pp. 132-3.

pliers and/or to manufacture their own inputs, regardless of cost.<sup>95</sup> The waste resulting from such diseconomies of scale, redundant investment, lack of standardization and

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<sup>95</sup> One writer describes the nature of Chinese "specialization" in the machinery industry as follows: "In the machinery industry, specialization means organizing the production of articles requiring identical (or similar) work process . . . in an appropriate way for centralized mass production with a view to constantly improving the designs and work process for the products, raising labor productivity, lowering production cost, and insuring high quality. At present, however, many units or departments do not organize specialized production according to work process or the special characteristics of the products. Instead, they are organizing specialized production according to different nomenclatures, different utilities, or different consumers. . . . For example, it is entirely proper for boilers used in the power industry and the heat converters used in the chemical industry, to be produced in the same plant, because of the similar work process required. However, there should be no valid reason for diesel engines to be classified for production according to different ways they are used, such as for industry, agriculture, railways, automobiles, ships and so forth. Instead, they should be organized as low-speed, medium-speed and high speed specialized production according to the requirements of the work process . . . The semi-finished products from forging for the machinery industries should be even more specialized. If we organize production according to different nomenclatures, utilities, or consumers, we can neither be free from the patterns of 'big and all-inclusive' nor attain the goal of development with greater, faster, better and more economical results. This type of 'specialized production' is based on a misinterpretation of the term." Zhao Dongwan, "Several problems with the developing machinery industry (part II)," Jingji Guanli no. 6, June 15, 1980, pp. 8-12, JPRS no. 76217 August 13, 1980, pp. 34-35. (emphasis added).

so forth, was incalculable.<sup>96</sup>

### **Independent Kingdoms**

The machine-building industry was a case in point. It was reported that more than 20 ministries and commissions had established 375 factories in almost all provinces, municipalities and regions to turn out, closely related and often virtually identical, internal combustion engines. And these operations frequently ran at no more than 40% of capacity.<sup>97</sup> Rather than procuring them from

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<sup>96</sup> In a country with so few vehicles, the proliferation of auto and truck factories, for example, was staggering. In 1979, the government reported that "106 automobile plants have already been constructed in 25 provinces, municipalities and autonomous regions, and most of them are still expanding and renovating their plants and building more plants in order to catch up. . . In Shandong, for example, 17 automobile plants have been built in 13 prefectures and municipalities over the last decade. Since there was no overall plan, the production of eight plants has already ended; and because of a shortage of raw materials, the three plants in Qingdao, Laiwu and Penglai only produced 1,600 vehicles last year--30% of their production capacity--with all three plants starving for raw materials." Xinhua, November 30, 1979, FBIS December 3, 1979, p. L15. And in April 1980, Renmin ribao reported that "We have more than 60 large and medium tractor plants and more than 100 manual tractor plants all over the country, and every plant produces 2,000 tractors on the average. But many of these plants are of a small scale; their efficiency of production is low, and their economic effectiveness is inadequate." April 29, 1980, p. 5, JPRS July 21, 1980, p. 114.

<sup>97</sup> Wenhui Bao, April 18, 1981, p. 3; FBIS April 23 1981 p. W2.



centrally positioned large-scale engine factories, the auto industry or the ship-building industry, every machine-building enterprise, from tractor and agricultural machinery plants to truck and auto factories, to railways and ship-building, manufactured its own engines. Moreover, they often did so from scratch. Within machinery plants themselves, vertical integration and self-sufficiency were carried to such an extreme that even Henry Ford's legendary River Rouge plant paled by comparison.<sup>98</sup> Engine factories not only had their own foundries and forges, and fabricated their own bearings, spark plugs, and so on, but many constructed their own lathes, mills, and related machinery to build the engines with, and, most maintained their own in-house repair shops to boot -- the latter often accounting for 20% of the work force. Workers sometimes even built their own housing and grew some of their

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<sup>98</sup> One study noted that in the United States, there were just 1,500 casting plants, 1.3% of the total number of machinery plants, to supply the entire industrial structure; Japan has just 570, or 2% of machinery plants. But in China, just the First Machine Building and the Agricultural Machine Building Ministries alone have more than 2,600 casting operations--more than 60% of the total number of plants in these two ministries. "With these many centers scattered apart from one another, it not only causes waste of investment in capital construction from the lack of full utilization, but it also makes it impossible to adopt advanced casting techniques on the production of small lots." Jingji Guanli, no. 6, June 15, 1980, pp. 8-12, JPRS no. 76217, August 13, 1980, p. 36.

own food!<sup>99</sup>

Decentralization and self-management were designed to break the grip on factories by ministries and local departments, to open up the "free flow of commodity circulation," and transform factories into "relatively independent commodity producers" relating to one another "horizontally" through market agreements and contracts.<sup>100</sup>

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<sup>99</sup> Thus, the party theoretical journal, Hongqi, described the tendency of enterprise to build "fully independent systems," "the more comprehensive the better . . . so they do not have to ask anyone for anything" -- a situation which had become generalized throughout the economy: "From the very beginning of construction, a lot of new units intend to form a complete set for everything. They build not only a closed water, electricity and communication network of their own, but also mechanical maintenance and auxiliary facilities of their own. Even two neighboring machine building plants would separately set up their own casting and forging shop, electroplating shop, spare part making shop and mechanical maintenance shop. 'They never contact each other though they can hear the sound of machinery from each other's workshops.' With a complete set of non-productive facilities, every plant becomes an independent 'community.' Waste caused from promoting . . . [such] duplicate construction is quite obvious; . . . it takes more investment, more land, more labor and more time; for production it needs comprehensive operation which is too complicated and tedious to improve specialized techniques; for the utilization of equipment and production capacity, it causes a great deal of idleness and waste. June 1, 1981, pp. 42-43, FBIS July 2, 1981, p. K10. (Emphasis added).

<sup>100</sup> Xue Muqiao, "Guanyu jingji gaigede yixie yijian" (Some opinions on reforming the economic system), Renmin Ribao, June 10, 1980, p. 5. "Organize the flow of commodities according to economic zones," Xinhua reporter's commentary August 12, 1978, FBIS August 21, 1978, pp. E20-1. See also the "Provisional Regulations Concerning the Development and Protection of Socialist Competition" (adopted by the State Council October 17, 1980) in Almanac of China's

From there, market pressures and state tax levers would suffice, it was argued, to compel enterprises to rationalize production, boost (or cut) output to meet demand, innovate and introduce new technology, develop new products, improve quality and service, cut costs, shed excess staff and workers, etc.<sup>101</sup> "Let the factories and

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Economy 1981, pp. 220-2. The "Regulations" stipulated inter alia that "no local authority or department is allowed to interfere with the rights which an enterprise is entitled to enjoy under government policies, laws and regulations, rights with regard to production, supply and marketing, personnel, finance and materials. Agreements and contracts concluded between enterprises will be honoured by both parties and protected by the laws of the state. If a party breaks a contract, it shall be held responsible economically and legally." (point 2). "In economic activities, no monopoly of commodities shall be allowed, except those which the state has specified to be handled exclusively by certain departments and units." (point 3). And "No area or department is allowed to enforce a blockade or to forbid the sale of outside products in its own area or department. It must ensure the export of the raw and processed materials it produces according to the state plan . . . It is illegal to adopt administrative means to protect the backward and to restrict the advanced, obstructing the normal circulation of commodities; such practices must be abolished." (point 6). Regulations regarding the enforcement of contracts were detailed in "A joint circular of the State Economic Commission, the General Administration of Industry and Commerce and the People's Bank of China on a number of questions regarding the supervision of economic contracts." (August 8, 1979) Almanac of China's Economy 1981, pp. 279-81.

<sup>101</sup> See eg. "Competition is a good thing," Renmin Ribao commentator's article of June 6, 1980, JPRS no. 76006 July 8, 1980, p. 4.

shops feel the pressures," one finance and trade official said, "If a product is poor in quality, sells at too high a price, or does not meet the demands of the market, trade departments can reject it and buy from other manufacturers." "Such competition is sure to put enterprises which are under constantly bad management and running big deficits in an unfavourable position." Some might have to change leadership, some have to close down."<sup>102</sup>

**From Autarky to Specialization by Comparative Advantage**

It was furthermore argued that market pressures combined with the breakup of departmental restrictions on the free flow of commodities, would force productive units to abandon wasteful duplication, and give up self-sufficiency in favor of specialization by comparative advantage. Whereas in the past every factory had striven for self-sufficiency and every locality and province had striven to build "independent and comprehensive economic systems," now it was maintained that competition would force these

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<sup>102</sup> Wu Tongguang of the Beijing Institute of Finance and Trade, Xinhua, March 24, 1979, FBIS March 27, 1979, p. L8 (emphasis added). Thus Renmin Ribao reported in June 1980 that "since competition started last year, products that serve no practical need have become unsaleable. Enterprises automatically reduce the production of what is in full supply and increase the production of what is in short supply." June 23, 1980 p. 5.

units to rationally assess their respective factor endowments and, à la Ricardo, invest and specialize accordingly. So it was suggested, for example, that because of its subtropical geographic location, natural endowments, and proximity to Hong Kong, Guangdong would do best to "gradually change the present self-sufficient, heavy industry-oriented industrial system into an economic system that focuses on agriculture and light industry . . . foreign trade and tourism."<sup>103</sup> Conversely, Liaoning, which has rich natural resources for developing heavy industry would be better off to abandon its past practice of "supplying its own needs in grain, pork and other farm and sideline products" regardless of cost, and instead, concentrate on its strong point, heavy industry.<sup>104</sup> And so on. By adapting to local conditions in this way, resources and labor would be more effectively utilized, waste and duplication eliminated, and industry more rationally reorganized.<sup>105</sup>

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<sup>103</sup> Renmin Ribao, June 10, 1980 pp. 1-2, FBIS June 19, 1980 p. L2.

<sup>104</sup> Ibid., pp. L2-3.

<sup>105</sup> Ibid., p. L3.

#### **IV. C. The Agricultural Responsibility System**

The government's strategy with respect to agricultural reform basically paralleled that of industry. Here too, increases in agricultural output and productivity were premised on the devolution of economic decisionmaking power onto the direct producers (the peasants), the substitution of market forces for state direction of agriculture, and an effort to promote greater specialization and marketization. Starting in 1978 the government introduced a series of sweeping reforms which, in the space of three to four years, transformed the face of agriculture in China and effected a virtual "second land reform." Agricultural reform strategy focused on decollectivization and the revival of various "agricultural production responsibility systems" (nongye shengchan zeren zhi). These, in one form or another, abolished egalitarianism and linked incomes with either work effort or output. In the most radical of these, which was eventually adopted nationwide, collectivized agriculture based on the commune-brigade-work team structure was

entirely broken up and replaced, ultimately, with individual peasant household farming.<sup>106</sup>

The first reforms, detailed in two major policy documents provisionally adopted at the CCP Third Plenum in December 1978, announced substantial improvements with regard to incentives, state investment, and marketing.<sup>107</sup>

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<sup>106</sup> What follows is a brief summary of the reform measures introduced since 1978. The agricultural responsibility system has become the subject of a growing and now voluminous secondary literature. Readers interested in more detail may wish to consult recent surveys by Robert F. Ash, "The evolution of agricultural policy," China Quarterly no. 116 (December 1988), pp. 529-55; and Reetsu Kojima, "Agricultural organization: new forms, new contradictions," China Quarterly no. 116 (December 1988), pp. 706-34. See also Nicolas R. Lardy, Agriculture in China's Modern Economic Development (Cambridge: Cambridge University Press, 1983); Keith Griffin, ed., Institutional Reform and Economic Development in the Chinese Countryside (Armonk, New York: M.E. Sharpe, 1984); William L. Parrish, ed., Chinese Rural Development: The Great Transformation (Armonk, New York: M. E. Sharpe, 1985); and Pat Howard, Breaking the Iron Rice Bowl: Prospects for Socialism in China's Countryside (Armonk, New York: M.E. Sharpe, 1985). Succinct summaries can also be found in Kenneth R. Walker, "Chinese agriculture during the period of the readjustment, 1978-83," The China Quarterly, no. 100 (December 1984), pp. 783-811; Y.Y. Kueh, "The economics of the 'second land reform' in China," The China Quarterly no. 101 (March 1985), pp. 122-31; and Andrew Watson, "Agriculture looks for 'shoes that fit': the production responsibility system and its implications," in China's Changed Road to Development, Neville Maxwell and Bruce McFarlane, eds., (New York: Pergamon Press, 1984), pp. 83-108.

<sup>107</sup> "Draft Regulations on Work in the Rural People's Communes" ("The 60 Articles"), in Issues and Studies, August 1979, pp. 100-115; and "Decision of the Central Committee of the Communist Party on Some Questions Concerning the Acceleration of Agricultural Development," in Almanac of China's Economy 1981, pp. 161-74.

First, the new regulations granted a 21% rise in the state purchase price for grain and a 50% rise for above-quota grain, as well as rises in the purchase prices of cotton, edible oils, sugar, animal by-products, aquatic and forestry products and other farm and sideline products, starting with the summer 1979 crops. They further affirmed that grain quotas and the agricultural tax would remain stable, and in some instances be reduced. And they announced that state prices for industrial inputs to agricultural -- machinery, chemical fertilizers, insecticides, plastics, and other items would be cut by 10-15% in 1979-80 to improve the peasants terms of trade with the state. Secondly, they promised that state investments in agriculture would rise to around 18% of total capital construction, and declared the government's intention to more than double the amount of low-interest long-term loans to be provided to the peasants for farm investment. Thirdly, the new regulations reinstated the peasants' private plots, and reopened rural and urban free markets for agricultural produce.

With regard to income distribution and the reorganization of production, however, these first reforms of 1978-79, were still relatively conservative. Decollectivization was restricted to the level of the production



team (which usually corresponded to the village or a smaller sub village unit of production consisting of several to many families). Reinstating the production team as the "basic accounting unit" meant that (a) work groups (gongzuo zu) contracted with the the state fulfill certain specified farm works (sowing, harvesting, etc.) or in other cases, to deliver specified quotas of crops, in return for their use of the land, and (b) the work groups were empowered to distribute the surplus in kind and cash among their members according to work point entitlements. In addition, bonuses were paid for overfulfillment of production. Land, draft animals, farm machines and irrigation equipment were to remain the collective property of the team.<sup>108</sup> Peasants were free to sell their privately produced output on the free market.

The reform leadership's initial resistance to further decollectivization is to be understood in the context of its objectives with respect to the peasantry. On the one hand it sought to free the peasants from the negative

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<sup>108</sup> Thus Renmin Ribao warned that further decollectivization "would result in a situation where groups scramble for land, labor force, draft animals, farm tools, water and fertilizers. Also, the stability of the production team as the accounting unit will be adversely affected or, at the worst, the collective economy will be undermined." See "Practice of fixing work quotas on a group basis should not lead to disintegration of the production team," February 21, 1979 p. 4, FBIS March 1, 1979, p. E15.

incentives built into the collectivized system (eg. egalitarian income distribution, and irrational cadre-bueaucratic mismanagement of the farms) so as to maximize output and productivity. On the other hand, it sought to maintain control over production (by fixing output quotas) and extract as much as possible of the surplus for accumulation. So the reforms of 1978-79 ruled out all egalitarian forms of income distribution in favor of systems that linked output to the group, or the individual (lianchan dao zu, dao lao). But they stopped short at division of land among households for individual farming (fentian dan gan) and explicitly prohibited contracting production directly to individual households. In short, the first phase of decollectivization essentially restored the system to the level of collectivization that prevailed in the mid 1950s and, in more constrained form, in the early 1960s.

However, in the climate of reform and relaxation initiated by the leadership, the peasants rapidly seized the moment and by the early eighties they had forced the government to abandon collectivization altogether. By the end of 1982 more than three-fourths of all teams had embraced the most radical form of household contracting, known as baogan dao hu ("contracting everything with the household"). In this system, peasant families (hu) and individuals (lao) contracted to fulfill specified output

quotas for both state procurements and collective retentions (i.e. collective welfare facilities, schools, etc.). They retained possession of all output over and above these quotas which they were free to sell either to the state at negotiated prices, or on the free market. The land was divided up among the families who were free to dispose of it as they wished (in return for a rent paid to the state in kind, in the form of quotas procured at less than market prices). The remaining means of production, tractors, animals and implements were either divided up and redistributed, or rented to the families from the collectives.<sup>109</sup> In the years since 1981, the government has been forced to legally sanction this peasant rush to

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<sup>109</sup> Wang Guichen and Wei Daonan, "On the household responsibility system," Jingji Yanjiu, no. 1, January 1981, pp. 64-7; Su Xing, "Zeren zhi yu nong- cun jieti suo yuzhi jingji de fazhan" (Responsibility system and the development of collective economy in rural areas), Jingji Yanjiu, no. 11, November 1982, pp. 4-9; Zhongguo Nongmin Bao (China Peasants Daily), February 10, 1983, p. 2; Walker, "Chinese agriculture," pp. 784-9; Kueh, "The economics of the 'second land reform,' " pp. 122-4. In interviewing Gansu peasants a Xinhua reporter noted that among the advantages the peasants described for the system, foremost was that the system could "eliminate many exorbitant taxes and levies and ease the commune members burdens. . . greatly reduce or completely eliminate the burden of sharing work points with any nonproductive personnel who do not work for the production team but receive work points from the team [i.e. cadres] . . . and prevent the higher levels from practicing egalitarianism and indiscriminate transfer of resources . . ." Xinhua, June 20, 1981, FBIS June 22, 1981 p. T1.

decollectivization. This was, in part, a response to the pressure from below, the peasants demand for the land. But it was also in response to problems of the overfarming of collectively owned land which resulted from the short one to three year leases stipulated in the earlier forms the responsibility system.<sup>110</sup> Consequently, in the effort to stimulate peasant investment in the land, Central Committee "Document No. 1" of January 1984 extended the peasant leaseholds to 15 years or more. Furthermore, it permitted virtually unlimited transfers of leasehold rights, with compensatory provisos that amount to land rent.<sup>111</sup>

**Grain Bases, Specialized Households,  
Agro-Industrial-Commercial Complexes**

As in industry, the reform leadership also planned to raise agricultural productivity by re-organizing agricultural production along the lines of specialization by comparative advantage. The relaxation of state controls combined with increasing market pressures would, it was hoped, both permit and compel producers to specialize,

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<sup>110</sup> See the discussion of this point in Y.Y. Kueh, "The economics of the 'second land reform,' " pp. 127-9.

<sup>111</sup> "Circular of the Central Committee of the Chinese Communist Party on Rural Work During 1984" ("Document No. 1, 1984"), translated in The China Quarterly no. 101, March 1985, pp. 132-42.

concentrate on market demand, introduce advanced technology, improved management, and boost productivity. The leadership called on each area to "concentrate on growing crops to which they are best suited."<sup>112</sup> So, regions with factor endowments suitable to growing grain and soybeans, especially the northeastern provinces of Heilongjiang and Jilin with their vast stretches of land, low population and potential for mechanization, were encouraged to establish "marketable grain bases."<sup>113</sup> Mountainous areas should emphasize forestry, coastal areas fishing, etc. Farming families were encouraged to transform themselves into "specialized households" (zhuan ye hu).

And to overcome problems resulting from "vertical" administrative separation of farming, industry and commerce, the leadership called for the establishment of agricultural-industrial-commercial complexes to promote "horizontal" economic linkages. These would further rationalize production by permitting production units to cooperate via contracts extending beyond the confines of administrative "ownership" or districts. In this way pro-

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<sup>112</sup> "Set up specialized bases for agriculture taking into account local conditions," Renmin Ribao commentator's article, December 18, 1978 p. 1, FBIS December 19, 1978 p. E16.

<sup>113</sup> Xinhua, July 14, 1980.

ducers could secure more reliable sources of raw materials, develop processing on the farms to cut wastage and expand the markets for their products.<sup>114</sup>

#### **V. JOINT VENTURES AND AN EXPORT STRATEGY TO PAY FOR MODERNIZATION**

The Deng leadership, faced with less than \$5 billion in foreign reserves in 1978, and less foreign trade in that year than Hong Kong (\$14.6 billion versus \$21 billion), reversed China's long-standing adherence to self-reliance and looked to financing its \$250-350 billion ten-year modernization program by means of a vast expansion of exports -- especially oil, coal, textiles and light manufactures. Analysts estimated in 1978 that China could boost exports at an average annual rate rate of 20%, to around \$31.3 billion by 1985. This would still have left a substantial deficit, but at that rate China could have paid for \$165 billion in foreign imports by 1985.<sup>115</sup>

Here again, the leadership argued that because the central ministries were so out of touch with the actual needs and capacities of production units and less well

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<sup>114</sup> Renmin Ribao, August 20, 1981 p. 1, 4; Luo Fu, "A 'dragon' of farming, industry and commerce," Beijing Review, August 4, 1980, pp. 17-26.

<sup>115</sup> Business Week, January 15, 1979, p. 48.

placed to judge the market, that local units and enterprises should be given responsibility for negotiating imports and exports and establishing joint ventures with Chinese and foreign capital on the mainland.<sup>116</sup>

After a year of foreign shopping expeditions in 1977, Chinese officials in February 1978, concluded their first long-term commitment with the industrialized world in nearly two decades, an historic \$20 billion eight-year trade pact with Japan.<sup>117</sup> Before the year was out they also signed a \$13.6 billion trade agreement with France, and an accord with the European Economic Community. The Sino-Japanese trade pact committed energy-short Japan to purchase 330 million barrels of Chinese crude oil and around 9 million tons of coal by 1982 -- in exchange for

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<sup>116</sup> Thus for example, the economist Xue Muqiao: "In foreign trade we must change the practice of relying solely on the foreign trade departments for negotiations with foreign businessmen. Production units not only should take part in negotiations with foreign businessmen but should take part in signing contracts, share foreign exchange earnings with the foreign trade departments. With the approval of the higher authorities, some production units may directly enter into cooperation with foreign businessmen." "It is necessary to reform our structure of economic management," op. cit., p. 39. See also Wei Yuming, "China's policy on absorption of direct investment from foreign countries," Beijing Review, July 26, 1982, pp. 18-22.

<sup>117</sup> Los Angeles Times, February 19, 1978. Business Week, May 29, 1978, pp. 40-41.

some \$10 billion worth of Japanese industrial plants, machinery and technology, and construction materials. These included an integrated steel complex to be built by Nippon Steel Corporation outside Shanghai (originally budgeted at around \$3-4 billion) that would boost China's steel output by 25%, a \$40 million copper smelter with an annual output of 200,000 tons, a synthetic leather plant, a color TV factory, several fertilizer plants, etc.<sup>118</sup> In April, the PRC gained entry into the IMF, and in October Deng Xiaoping reversed China's long-standing commitment to paying all its bills in cash, by announcing that China would borrow outright in the West, and on a large scale.<sup>119</sup> By the end of the year China had taken bids on a staggering array of capital items and technology.<sup>120</sup> And

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<sup>118</sup> Peter Weintraub and Melinda Liu, "China buys its way towards a vision of self-reliance," Far Eastern Economic Review, July 7, 1978, pp. 34-37.

<sup>119</sup> The New York Times, December 27, 1978.

<sup>120</sup> The largest of these were contracts to develop China's estimated 30 billion barrel reserves of offshore oil. Dozens of companies including Phillips, Exxon, Pennzoil, Union Oil Co., Arco and other U.S. companies, as well as European and Japanese companies were competing for these contracts. A German group headed by Schloemann-Siemag was asked to bid on what, if built, would be the world's largest steel plant to be constructed in Hebei province. U.S. and Bethlehem Steel companies were negotiating contracts for iron ore-processing plants worth more than \$1.1 billion. Four West German mine equipment producers signed a protocol for \$4 billion in equipment. Ford and General Motors were negotiating the sale of truck and heavy equipment, as well as assembly plants. Deere & Co. sold China



schemes to pay for these ranged from barter, for example Chinese oil against Dutch port building, to "buy back" arrangements where investors provided technology in return for finished goods, to deferred payments (supplier credits) and direct loans.

But perhaps the boldest of the new open door policies was the government's formal establishment, starting in May 1979, of several "Special Economic Zones" (SEZ's) -- Shen-

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\$1 million worth of farm equipment for testing, and were discussing licensing arrangements to build plants in China to produce Deere-designed farm tractors and implements. Continental Can Co. was negotiating to modernize China's food processing industry. British and Japanese companies won orders for more than \$196 million in machinery. A Dutch consortium won a \$2 billion contract to build a coal port on the Chang Jiang (Yangtze) River. A Copenhagen firm signed up to build container facilities and rebuild the Tianjin and Shanghai ports. European and Japanese shipyards were competing to sell freighters and specialized ships; and Hitachi Shipbuilding & Engineering Co. and Mitsubishi Heavy Industries Co. won contracts to modernize the shipyards in Luda and Shanghai. Japan National Railways was negotiating a complex contract to modernize China's antiquated rail system and rolling stock, and European companies were competing to sell locomotives. Japan's Kanebo Ltd. was asked to bid on two polyester plants with a planned capacity greater than the entire Japanese polyester polymerization industry. Westinghouse's French licensee, Framatome, won a \$2.2 billion contract to supply the first of perhaps several 900-Mw nuclear reactors. Fiat was negotiating to build an agricultural machinery plant. Etc. etc. And this is not to mention the military's negotiations for Mirage jets and Tiger tanks! See Business Week, November 6, 1978, pp. 76-7, and December 18, 1978, pp. 53-4. Los Angeles Times, Aug. 6, 1978. The New York Times, December 5, 7, 19, 1978.

zen, Zhuhai and Shantou in Guangdong Province, and Xiamen (Amoy) in Fujian.<sup>121</sup> These were set up as export-processing zones modeled after Taiwan's "free trade zones," with the aim attracting foreign, especially high technology industries, boosting employment and foreign exchange earnings, and gaining a greater return on investments. Local officials were granted extraordinary freedom to negotiate directly with foreigners. Entry and exit were strictly controlled for Chinese and freely open to Westerners. In general, the Chinese were to provide land, plant buildings and labor, and foreign firms were to furnish raw materials and machinery, and to handle marketing.<sup>122</sup>

In the zones, as elsewhere in China, the joint ven-

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<sup>121</sup> For fuller discussions of the SEZ's, see Xu Dixin, "China's Special Economic Zones," Beijing Review, December 14, 1981, pp. 14-21; James B. Stepanek, "Direct investment in China," The China Business Review (September-October, 1982), pp. 20-7; Jerome Alan Cohen, "Equity joint ventures," The China Business Review, November-December, 1982, pp. 23-30; Joy Barson, "Special Economic Zones in the People's Republic of China," China-International Business, vol. 1, no. 5 (1981), pp. 461-94; and Edith Terry, "Decentralizing foreign trade," China-International Business, vol. 1, no. 5 (1981), pp. 445-60.

<sup>122</sup> Xinhua, December 28, 1980; Wenhui Bao (Hong Kong), June 29, 1981, p. 2, FBIS July 6, 1981 pp. W3-5.

ture law<sup>123</sup> permitted Chinese production units and foreign capitalists split the profits (and losses) in proportion to their respective investments. But western capitalists were granted far more liberal conditions within the zones. These included the right to set up wholly owned production facilities, income tax rates of only 15% (half the 30% rate fixed for joint ventures in China outside the zones--and even this was waived for the first two profit-making years of enterprises with an investment of more than \$2.5 million or with advanced technology), long leases and rents at a fraction of those in Hong Kong, irresistably low wages and, in theory at least, the right to hire and fire workers without restraint.<sup>124</sup>

The first joint ventures were established in Shenzhen in 1978, and by 1981, several hundred industrial commercial and farming enterprises were operating there. In 1980, Fujian became the first Chinese province to establish an

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<sup>123</sup> See "The Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment" adopted September 10, 1980 by the Fifth National People's Congress (third session), and "Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment" approved by the State Council December 10, 1980, in Almanac of China's Economy 1981, pp. 228-9 and 230-3.

<sup>124</sup> Wenhui Bao, June 29, 1980 p. 2.

investment company to attract capital from overseas, and the first to borrow directly from abroad (two loan agreements totalling \$33 million from American bankers).<sup>125</sup>

### **The New Chinese Model?**

As the foregoing survey may indicate, in important respects -- most particularly agricultural decollectivization, industrial decentralization and the opening to the West -- China's market socialist reforms have been bolder and far more extensive than those implemented anywhere previously, and far more extensive than those currently envisioned by the Soviet leadership. Indeed, in an extraordinary historical volte-face, Moscow's current reformers now look to Beijing to Beijing "to show the way." Thus, the Chinese experiment stands perhaps, as the model by which the entire market socialist project may be judged. As it turned out, the history of China's market socialist experiment indeed holds some profound and important lessons -- but as we shall see, these offer little consolation to Gorbachev or to market socialists in the West.

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<sup>125</sup> Xinhua, December 20, 1980; The New York Times, April 21, 1980.

## **CHAPTER 2**

### **MARKET REFORM IN THE COUNTRYSIDE: A BUMPER CROP OF PROBLEMS**

#### **I. "DIZZY WITH SUCCESS": AGRICULTURAL PERFORMANCE AND RURAL INCOMES 1978-84**

Up until recently, China's agrarian reform had been hailed as a stunning success and held up as a model for would-be reformers elsewhere, notably in the Soviet Union. Certainly, by many measures, China's agrarian reform has been highly successful. Gains in output and rural living standards since 1978 have been unparalleled since the communists came to power. Between 1978 and 1984 China's agricultural output grew at unprecedented rates despite negligible increases (and in some instances reductions) in sown area, despite declining investments in agriculture, and despite "natural calamities seldom seen" in 1980 and 1981, and serious drought and floods again in 1983.<sup>1</sup> Between 1978 and 1984, the gross value of China's

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<sup>1</sup> See the statistical Communiques on fulfillment of the plans for 1980-84. The quoted comment on impact of the weather is from the Communique for 1980.

agricultural output climbed at an average annual rate of 15.9% -- five times the 3.2% average rate of growth over the span 1953-78.<sup>2</sup> From 1978 to 1984, grain output grew by one-third, from 305 to 407 million tons. Cotton output tripled in the same period, and production of oil-bearing crops more than doubled. (See Table 2.1 below). The record grain harvest of 1984, the third consecutive record harvest and the fourth record harvest in the six years since 1978, not only exceeded the expectations of the reformers (this was the only one of Hua Guofeng's original 1978 targets to have been met or surpassed) but more importantly, reestablished China's basic self-sufficiency in staple food, a situation the country had not enjoyed since the early 1950's. The huge increases in cotton output turned China around from one of the world's biggest cotton importers, into an exporter. By 1984, the Chinese government found itself in the extraordinary and quite unexpected position of facing a glut of grain, cotton and other farm produce -- and having to scramble to build additional granaries and warehouses to store it all. Gains in output were so substantial that in 1984 the government felt confident enough to reduce the number of agricultural

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<sup>2</sup> State Statistical Bureau, Statistical Yearbook of China 1986, p. 31.

products subject to state monopoly purchase and supply from 21 to 12 , and to abolish rationing of some foods in the urban centers.<sup>3</sup>

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<sup>3</sup> China Daily, July 26, 1984. The twelve still included rice, wheat, and corn, peanut, rapeseed and cotton seed oil, and graded cotton. The number of items on which the state set fixed purchasing quotas was also cut from eighteen to nine. Those which could henceforth be freely traded included beef, mutton, eggs, apples and citrus fruits. Quotas remained on pigs, jute, hemp, tea, wool, and vegetables for larger cities. Ibid.

**Table 2.1: Growth of Agricultural Output 1978-87**

Year	Gross value (billion current yuan)	Rate of change (% per year)
1953-78		3.2
1979	189.6	21.0
1980	218.0	15.0
1981	246.0	12.8
1982	278.5	13.2
1983	312.3	12.1
1984	379.0	21.4
1985	361.9	-4.5
1986	394.7	3.5
1987	444.7	4.7

Notes: 1) Figures from 1985 through 1987 are not strictly comparable with those for the years up through 1984, for two reasons. First, starting in 1985 government statisticians deduct the value of the output of village industries and count this under industry, whereas in previous years this had been subsumed under agriculture. (See the Statistical Yearbook of China 1986, p. 31, note 1).  
2) Secondly, since all figures as officially given are expressed in current prices, they increasingly inflate the value of output in recent years, particularly since the mid-80s, when inflation has run from 10-20% per year.

Sources: 1953-85, State Statistical Bureau, Statistical Yearbook of China 1986, p. 31.  
1986, State Statistical Bureau, "Communique of 1986 Economic and Social Development, Beijing Review, March 2, 1987, p. 20.  
1987, State Statistical Bureau, "Statistics for 1987 Economic and Social Development, Beijing Review, March 7-13, 1988, p. II.



**Table 2.2: Output of Major Farm Products 1978-87**  
(million metric tons)

Year	Grain	Cotton	Oil-bearing crops
1978	304.7	2.2	5.2
1979	332.1	2.2	6.4
1980	320.6	2.7	7.6
1981	325.0	3.0	10.2
1982	354.5	3.6	11.8
1983	387.3	4.6	10.5
1984	407.3	6.3	11.9
1985	379.1	4.1	15.7
1986	391.1	3.5	14.7
1987	402.4	4.2	15.2

Note: "Grain" includes rice, wheat, corn, soybeans and tubers. "Oil-bearing crops" includes peanuts, rapeseed, sesame and other miscellaneous seeds.

Sources: 1978-85, State Statistical Bureau, Statistical Yearbook of China 1986, p. 143.

1986, Beijing Review, March 2, 1987, p. 20

1987, Beijing Review, March 7-13, 1988, p. II.

No less impressive, after decades of stagnation, in just four years from 1979 to 1982 average annual per capita peasant cash incomes doubled from Y136 to Y270.<sup>4</sup> By the end of 1985 peasant incomes topped Y397.<sup>5</sup> Moreover, as can be seen in Table 2.2 below, the rising tide of incomes lifted China's peasantry virtually as one mass. Whereas in 1978 some 65% of the rural population had cash incomes

<sup>4</sup> Zhongguo Nongmin Bao (China Peasant's Daily), May 3, 1983, p. 1; Statistical Yearbook of China 1986, p. 583.

<sup>5</sup> Statistical Yearbook of China 1986, p. 583.

below the government's indexed "poverty level" of Y150, by 1985 fewer than 10% had incomes below this level.<sup>6</sup> And, as the media has reported extensively, rising rural incomes fueled an unprecedented boom in spending on housing and consumer goods. By the mid-eighties, it had become commonplace to read enthusiastic stories in the Chinese and foreign press about peasants packing home color TV's, refrigerators, pianos, even trucks, crop dusting aircraft and computers.<sup>7</sup> China's factories haven't been able to turn out sufficient consumer goods to keep up with peasant demand. In what the press dubbed a "housebuilding craze," nearly half of China's 176 million peasant families have built new homes since 1978 -- more new housing than was constructed in rural China in the previous thirty years.<sup>8</sup> The improvements have been so dramatic that despite urban wage hikes and subsidies, peasants in the more prosperous

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<sup>6</sup> Ibid.

<sup>7</sup> See e.g. "Peasants' successful climb to prosperity," China Daily, September 7, 1984; and Christopher S. Wren, "First priority for Peking: improving the quality of life," The New York Times, December 16, 1984.

<sup>8</sup> China Daily, September 7, 1984. Moreover, while urban living conditions have grown considerably more crowded in recent years, in the countryside, household living space grew from 8.1 to 14.7 square meters per person from 1978 to 1985. Statistical Yearbook of China 1986, p. 582.

regions are closing the gap between urban and rural incomes.<sup>9</sup>

Table 2.3: Per Capita Rural Incomes (current yuan)

Rmb (% share)	1978	1981	1983	1985
+500	0	3.2	11.9	22.3
300-500	2.4	19.4	34.5	39.8
200-300	15.0	34.8	32.9	25.6
100-200	49.3	37.9	19.3	11.3
0-100	33.9	4.7	1.4	1.0

Source: Statistical Yearbook of China 1986, p. 582.

## II. FROM BOOM TO CRISIS: THE CONTRADICTIONS OF MARKET SOCIALISM IN THE COUNTRYSIDE 1985-88

In view of the impressive growth in farm output and rural incomes, the Deng leadership had good reason to feel gratified with the success of its rural reforms. By 1984-85 the rural economy appeared to have indeed "taken off" as hoped: agricultural reform seemed essentially complete, and the Party could turn its attention to the urban economy. But impressive those these gains appeared, they were, for the most part, based on one-time improvements (decollectivization and the sharp price increases

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<sup>9</sup> The State Statistical Bureau reported that between 1978 and 1982 the peasants' net income rose by 92.7% while that of urban workers rose by 58.5%. Annual per capita living expenditures for peasants rose to Y220 from Y116 in 1978, an increase of nearly 90%, while in the same period expenditures by urban workers rose to Y471 from 1978's Y311, an increase of 37%. Xinhua, May 6, 1983.

for peasant output in 1979-81) which could not, or in the case of price increases, would not, be replicated. Consequently, continued rapid gains in output, in productivity, and incomes could not be sustained. The bubble burst at the end of 1985 when the government reported that after a string of bumper harvests, China's 1985 grain harvest dropped by more than 7%, or some 28 million tons, from the record 407 million ton crop of 1984. Cotton production also fell by one-third (production of oil-bearing crops, the third most significant category of farm crops, increased substantially in 1985 but fell off the next year). (See Table 2.2). Reduced grain output since 1985 caused animal feed shortages, sharp price increases, and a slump in pig-farming with the result that pork rationing had to be reintroduced in 1987. The 1985 downturn -- the largest one-year fall in grain output since the Great Leap Forward -- was a huge setback for Deng and prompted demands by many in the leadership, notably Chen Yun, to "grasp grain production" and tighten the reins on the peasantry.<sup>10</sup> In September 1985, a

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<sup>10</sup> As early as March 1985, the government stated that the proposed shift from mandatory procurement quotas to contractual "free" (zi you) exchange with the peasantry, hinted at by Premier Zhao Ziyang in May 1984, "does not mean that grain production will be carried out without guidance and plans, but means that the state will plan and guide grain production through contracted grain purchase." See "In no way should the grip of grain production be relaxed," Renmin Ribao Commentator's article of March 19, 1985, p. 2, FBIS March 25, 1985, p. K10.

national Party conference that had been scheduled to affirm the Deng line, ended in dissension over the consequences of falling agricultural output. Chen Yun complained that Deng's laissez-faire approach had resulted in peasants abandoning grain production, and even farming altogether, for higher earnings available in nonfarm pursuits, especially trading.<sup>11</sup> Chen also chided the official press for exaggerating the number of so-called wanyuan hu, or "10,000 yuan households" (peasant households with annual incomes of this amount or more -- roughly equivalent to U.S. \$3,500 in 1985). In reality, he said, "their number is extremely small." Rural living standards had risen dramatically in areas like the Yangtze and Pearl River deltas, which enjoy fertile soil,

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<sup>11</sup> Chen Yun's speech was published in Beijing Review, September 30, 1985, pp. 18-20. The decline in grain production had long been predicted. Between 1978 and 1982, the grain sown area fell from 120 million hectares to 113 million, before rising slightly to 114 million hectares in 1983. In December 1982, Premier Zhao Ziyang warned that: "Land suitable for growing grain must grow grain and not be transferred to other crops; this must serve as a long-term policy decision from which there must be absolutely no deviation." Cited by Professor Kenneth R. Walker in "Chinese agriculture during the period of readjustment, 1978-83," The China Quarterly, no. 100 (December 1984), pp. 790-1. As Professor Walker rightly observed, this begged the entire question of what is "suitable" and moreover, belied the government's putative claim that such plans for sown area were in theory no longer mandatory.

ample water and a mild climate, and access to urban markets. But in more backward and mountainous regions like Guizhou or Hunan in the southwest, or in Gansu and Ningxia in the northwest, conditions improved little if at all.<sup>12</sup> And ironically, Guizhou was one of the first provinces to adopt the responsibility system.

Now, at the time, many analysts said that the decline in the rate of agricultural growth in 1985 was in fact a rational response to market conditions following the grain glut of 1984, that "China's farmers have shown themselves to be capable of responding flexibly and rapidly to market changes." Therefore the decline was actually an indicator of the success rather than the failure of the market reform strategy.<sup>13</sup> In a sense this was correct. Farmers did respond to comparatively low prices for grain by disinvesting from grain and shifting their resources elsewhere. But it is questionable whether this validated the reformer's overall strategy -- since the decline in grain (and cotton, etc.) output was certainly not what the reformers expected or intended. On

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<sup>12</sup> Christopher S. Wren, "Despite rural China's gain, poverty grips some regions," The New York Times, December 18, 1984.

<sup>13</sup> Robert Delfs, correspondent for the Far Eastern Economic Review, February 18, 1988, p. 66.

the contrary they have consistently sought to maximize grain output without raising quota-procurement prices. The Seventh Five-Year Plan (1986-90) called for 425 million tons of grain to be produced in 1990. And, in his opening address to the National People's Congress in March 1988, Acting Premier Li Peng said, "We must strive to produce 500 million tons of grain by the end of the century, which will mean an average annual increase of 8 million tons."<sup>14</sup> The reluctance of "market oriented" peasants to meet targeted output and delivery quotas forced the government to spend \$1 billion, roughly one-tenth of its scarce foreign exchange reserves, to import 14 million tons of grain in 1987. With the present population growth of around 1.3% per year, grain consumption will rise by about 15 million tons per year, which means that imports will have to continue for years to come -- at the expense of the reformers' plans for investment in other areas.<sup>15</sup> It is hardly surprising, therefore, that the reformers have responded to peasant recalcitrance by "grasping grain production" -- curtailing free market

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<sup>14</sup> "Report on the work of government," March 25, 1988, in Beijing Review, April 25-May 1, 1988, p.29.

<sup>15</sup> Adi Ignatius, "Despite recent gains, China is again facing a shortage of grain," The Wall Street Journal, January 19, 1988.

sales, reimposing sown area requirements, and so forth.<sup>16</sup>

### **The Market Versus the Plan**

The difficulties of eliciting greater peasant output and increasing farm incomes need to be understood in the context of the contradictory interests between the state, which has sought to maximize agricultural output, enforce a specific pattern of planned output, and maximize surplus extraction from the agricultural sector -- and the peasants, who seek to maximize their own incomes and consumption. With respect to this basic conflict, decollectivization and its associated reforms, were sufficient to provide the basis for significant short-run gains in output and peasant incomes, but in the medium- to long-run, the limitations of small-scale family farming combined with the determination of the government to impose state planning and surplus extraction, posed enormous obstacles to further developing the productive forces and especially to increasing productivity in agriculture. The problems the reformers face may be grouped under five headings: (a) declining economic incentives; (b) limits to economic development on the basis of small-scale fam-

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<sup>16</sup> Adi Ignatius, in the article just cited, reports that in Shanxi province, cereal production has fallen so far that officials, desperate to reach output targets, have warned farmers that their children will be expelled from school if grain quotas aren't met.



ily farming; (c) obstacles to increasing investment in agriculture; (d) barriers to commodity production and exchange in the rural economy; (e) bureaucratic constraints on rationalizing agricultural production; and (f) productivity problems arising from the deterioration of the rural economic and social infrastructure. I shall discuss these roughly in order.

#### **A. Declining Economic Returns From Agriculture**

Although the reformers pushed marketization the farthest in the agricultural sector, it is, ironically, the government's overriding determination to enforce planned agricultural production and procurement which is, in my view, the root cause of the present agricultural crisis in China. As we noted in the previous chapter, decollectivization largely removed the government from direct planning of agricultural production. Specific orders for the required sown area of particular crops, for example, were largely discontinued. At the same time, grain procurement prices were raised, prices for many agricultural sideline products were deregulated, and, the free markets were reopened. Yet the government continued to enforce planned production of priority crops (most importantly grain) indirectly by its refusal to abandon compulsory state procurement (at below market prices). Deng and Zhao rejected Mao's extreme isolationism in

favor of a measured opening to the world market, but, for reasons we shall come back to later, they have never abandoned Mao's insistence that China should be self-sufficient in food production, especially grain. Instead, the reformers insist that grain is a "special crop," the production of which is not to be left to the whim of market forces.<sup>17</sup> But in truth, the same could be said for other food and industrial crops, most of which are still subject to planned procurement and state-controlled pricing at sub-economic rates. Indeed, the state's refusal to abandon such "irrational" pricing has been blamed for declines in the output of other crops as well.<sup>18</sup> Thus the dilemma for the reformers is as follows: In attempting to enforce the plan by imposing a substantial rent in kind on cropland (compulsory grain delivery quotas at sub-economic purchase prices) while simultaneously loosening restraints on mobility and encouraging the growth of much more profitable sideline and rural industrial ventures, the reformers created a situation in which economic forces pushed the peasants to look for avenues of escape

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<sup>17</sup> See Han Baocheng, "Grain production: today and tomorrow," Beijing Review, February 8-14, 1988, p. 7.

<sup>18</sup> See e.g. An Weihong, "Irrational sugar price undermines production," China Daily, July 25, 1988.

from low-profit farming, while at the same time, the reforms themselves opened up just those opportunities to escape -- and in the process -- to undermine the government's planned priorities.

This basic conflict of interests between the state and the peasants did not come to the fore until the mid-1980s. In the first years of reform, by far the biggest share of rising peasant incomes came not from free market sales nor from income from work in rural industries, but simply from a massive transfer of income from the state to the peasantry. In the three years from 1979-81, the state paid out an additional ¥56 billion, or ¥70 per capita, to the peasants in the form of increased procurement prices and remitted taxes.<sup>19</sup> This accounted for 80% of the increase in rural per capita income in the same period, which grew from ¥136 in 1978 to ¥223 in 1981, an increase of ¥87. This was, obviously, very costly to the government. Yet, fearful of urban unrest, the government resisted passing on these increased costs to the urban workers, with the result that outlays for government food subsidies increased dramatically, greatly contributing to the huge state budget deficits of 1979-80 and subsequent years. Thus, in March 1982, the government put the

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<sup>19</sup> China Daily, August 25, 1982, p. 4.

peasants on notice that such windfalls would not be repeated, stating that "we cannot raise the procurement prices every year . . . regardless of the degree of development of the national economy . . ." and that future increases in peasant incomes would have to come from rises in productivity and marketable output.<sup>20</sup>

Now the peasants could only be persuaded (voluntarily) to continue raising farm (and marketable) output so long as farm production was profitable -- that is, so long as the state continued to raise procurement prices for quota output and/or so long as they could sell their surplus, or some portion of it, on the free market. Free market prices (shijia) have varied but are generally substantially higher than those of state prices (gongjia, or paijia). To make matters worse, the costs of agricultural inputs: machinery, fuel, fertilizer, etc. have risen sharply in recent years, while grain prices have not been increased.<sup>21</sup> Consequently, the price scissors gradually forced grain growers' incomes down to levels that were 50 to 60 percent lower than those of

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<sup>20</sup> Renmin Ribao, March 12, 1982 p. 3, FBIS March 18, 1982, pp. K13-14.

<sup>21</sup> China Daily, November 26, 1988.

peasants engaged in rural industries, commerce, and service trades.<sup>22</sup>

Obviously, given the price disparity, if the reformers were primarily interested in maximizing agricultural output (and peasant incomes), the way to do so would have been to abandon the system of mandatory planning and purchase altogether, permit a fully free rural market, let the peasants market all the produce they wish, and trade industrial goods for agricultural produce on the basis of free (non-exploitative) equal exchange. Of course, this would have meant sharply higher food costs. Unless these costs were to be passed along to urban consumers, the government would have had to pay out still more for subsidies, or else it would have had to reduce expenditures in other areas, most probably its massive industrial modernization plan. But the reformers chose to resist full marketization of the rural economy, and to enforce planned production and procurement.

When, as under Mao, peasants were prohibited from leaving the farms, they had little choice but to remain in agriculture and hand over their surpluses to the state. But decollectivization and successive relaxations of migration and employment restrictions have greatly

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<sup>22</sup> China Daily, January 1, 1986.

facilitated peasant mobility. Consequently, given the government's resistance to continued increases in quota purchase prices, vast numbers of peasants began to seek ways to get out of farming, or at least agriculture, and take up more lucrative pursuits.<sup>23</sup> This not only caused a decline in the output of several crops, but also precipitated the greatest mass exodus from the land since the industrialization of the 1950s. The result has been an unprecedented increase in urbanization. In 1953, 87 percent of China's population lived in the countryside. As recently as 1979, 79 percent still lived in the countryside. But by 1987 officials estimate that some 32-37 percent of the population now live in cities and towns.<sup>24</sup> And of those peasants who remain in the countryside, a growing proportion of household incomes in recent years has come from non-agricultural employment: employment in rural industries, local employment in trade and transportation and construction, and remitted income

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<sup>23</sup> According to a report from Sichuan Province, in recent years grain grower's incomes were usually 50 to 60 percent lower than those of peasants engaged in rural industries, commerce and service trades. China Daily, January 1, 1986.

<sup>24</sup> A. Laquian, "China attempts to slow down growth of urbanization," China Daily, October 1, 1987; Kim Woodward and Judith Banister, "A tale of new cities," The China Business Review, (March-April 1987), p. 12.

from family members' employment in urban centers. (See Table 2.4).

**Table 2.4: Rural Household Income by Source (percent)**

	1978	1982	1985	1986
Net income, productive	92.0	87.8	88.0	88.4
Agricultural production	85.0	75.4	66.3	65.8
Non-agric. production	7.0	12.4	21.7	22.6
Net income, non-productive	8.0	12.2	12.0	11.6

Notes: 1) "Agricultural production" refers to net income of peasants engaged in farming, forestry, animal husbandry, sideline occupation and fishery.  
 2) "Non-agricultural production" refers to net income of peasants engaged in rural industry, construction, transport, commerce, and catering trade.  
 3) "Net income, non-productive" refers to income sent back by those working elsewhere, income received from collective accumulation fund and public welfare fund, and income received from the state budget.

Source: Statistical Yearbook of China 1986, p. 583, table 4.  
Statistical Yearbook of China 1987, p. 619, table 4.

## **B. Fragmentation and Parcelization of the Land**

Secondly, to the extent that the reforms actually did increase economic incentives to the peasants to raise output, especially for the free market, the reforms themselves have, ironically, in many ways rendered it more difficult to raise output and productivity beyond certain levels. As is well known, China's arable area is extremely

small in relation to the population. There is little or no room for expansion, and in fact, rural industrialization and house-building has steadily reduced farmland in recent years. China's per acre grain yields are already among the highest in the world -- because China's limited arable is very intensively farmed. So increased labor inputs have tended to yield sharply diminishing returns. It is generally agreed therefore that to significantly raise output beyond current levels would require increases in productivity which would have to be based on specialization, mechanization, intensified fertilization and pest control, and increased economies of scale.<sup>25</sup> It was, of course, precisely these sorts of productivity-increasing methods that the reformers hoped the peasants would seek to introduce with the reforms. And here and there, the peasants have actually sought to introduce such methods and technologies -- especially in sideline production for market, such as animal husbandry, truck gardening, aquatic products, and so forth. But, by and large, there has been little industrialization of farming as result of the reforms. This is mainly because continued state surplus extraction makes most farming unprofitable. But it is also

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<sup>25</sup> See e.g. the World Bank, China: Long-Term Development Issues and Options, chapter 3 and Annex 2.



because decollectivization has sharply reduced the scope for the introduction of advanced techniques and technologies, by among other things, reducing economies of scale.

Over much of rural China, decollectivization fractured once consolidated fields into tiny parcels reminiscent of the open-field strip farming of medieval Europe. This has sharply reduced the potential of economies of scale, and in many instances, all but ruled out mechanization. With twice as many people now living on the land than before the revolution, the post-1978 equal share-out left the land even more fragmented than the original land reform of the early 1950s. The American farmer-writer, William Hinton, who worked on experimental farms in North China both before and since the reforms, reported that on the north China plain today, family holdings are sometimes dispersed across the fields in strips no more than a yard wide, too small even to get a cart down them, much less turn around a tractor. In some places, almost all work of cultivation is done by hand.<sup>26</sup> In rice growing regions,

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<sup>26</sup> Lecture notes, New York December 4, 1985. See also Hinton's article in the November 1983 issue of Monthly Review, "A trip to Fenyang County: investigating China's new family contract system," pp. 1-28. Also, see Tan Jinwei's defense of the need for centralized brigade control for the rational employment of tractors in Guangdong in "Agricultural machinery should be employed in an organized fashion," Jingji Guanli, no. 8, August 25 1979, pp. 30-34.

much planting that was formerly done with tractors is now done with oxen.<sup>27</sup> These observations have been corroborated by reports of declining sales of large agricultural machinery, and of communes and brigades selling off large machinery<sup>28</sup> and by complaints in the press of shortages of small- and medium-sized farm machinery and hand implements.<sup>29</sup> (See also below part II.B). So the

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<sup>27</sup> Lu Yun, "Will farm mechanization be slowed?," Beijing Review, November 19, 1984, p. 47.

<sup>28</sup> Eg. Nanfang Ribao, June 10, 1980, p. 3.

<sup>29</sup> Nanfang Ribao, April 19, 1980, p.2. Renmin Ribao, April 27, 1981, p. 2. Renmin Ribao noted in January 1982, that after the implementation of the responsibility system in production, demand for big machinery fell off and the pressing need was for a reorientation of farm machinery production toward the production of small machines and hand implements: "With the exception of the northeast and northwest . . . in many places, cultivated area is limited and scattered and economic development is restricted. Therefore, what they need are a great number of various types of small farm machines and semimechanized farm tools drawn by men or animals, and other manual farm tools." January 30, 1982, p. 2, FBIS February 3, 1982, p. K21. Xinhua reported that in the first six months of 1982 sales of semi-mechanized farm implements, hand tractors, pumps and rubber-tired handcarts increased by 24 to 36 per cent, while farm machinery sales as a whole only increased by 8% for the same period. August 25, 1982. With the shift to smaller-scale and more diversified production, the government has urged the farm machinery industry to cut back on the production of traditional crop oriented machines and tools (tractors, engines, combine harvesters, plows, rakes and seeders), produce more appropriate tools and machinery, and especially begin producing mechanized and semimechanized machinery for livestock breeding--feeding, fodder supply, slaughter and processing, cold storage, transportation and marketing. Renmin Ribao, May 9, 1983, p. 3.

fragmentation which was the product of the agrarian reform (the responsibility system) has, at least in the short run, reduced the potential for productivity increases through economies of scale. Parcelization has also led, in short order, to growing social polarization based initially on family differentials in labor resources, investment capital, and skills. In 1981, cadres at Fenghuo brigade in Anhui showed the Australian sinologist Andrew Watson, family strips lying side-by-side in which wheat had been planted too early, too late and just right. The cadres also pointed out that after the previous harvest some families were in a position to buy fertilizers and other inputs while other families were not.<sup>30</sup> These incipient differentials were the basis for the increasing polarization that has become more and more apparent in more recent years (on which more below).

### C. Declining Investment in Agriculture

Thirdly, contrary to the reformers' expectations, investment in the agricultural sector has slowed markedly and shows little prospect of increasing in the near

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<sup>30</sup> Watson, "Agriculture looks for 'shoes that fit,' " op. cit., p. 100.

future. This decline is, in part, because state expenditures for agriculture, which the government promised in 1978 to raise by a percentage point to 8%, instead fell both relatively and absolutely.<sup>31</sup> State expenditures rose from 6.9% of budgeted outlays in 1978 to 7.1% in 1979, but dropped back to 5.1% in 1985 and 3% in 1986, before recovering slightly to 4.8% in 1987.<sup>32</sup> Perhaps more significantly, state investments in agricultural capital construction, mainly water projects, dropped from an average 11.9% of total investment in capital construction in the pre-1979 years to about 3.4% by 1988.<sup>33</sup> This decline in direct state funding has only been partially offset by increases in bank credits extended to agriculture. These did increase after 1978 (as part of the overall effort to shift to reallocate investment capital as "loans" obtained through the banks instead of as previously direct and costless government grants distributed by state agencies), but at a decreasing rate since 1981 so that the volume of

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<sup>31</sup> Lardy, "Agricultural reforms," pp. 94-95; and idem., Agriculture in China's Modern Economic Development, pp. 101-2. The government's commitment was expressed in its 1978 "Decision" on accelerating agricultural development.

<sup>32</sup> Ibid. Table 2, p. 96; and China Daily, November 19, 1988.

<sup>33</sup> Beijing Review February 8-14, 1988, p. 7

agricultural loans was equal to less than a quarter of state expenditures in 1983.<sup>34</sup> Moreover, accumulation funds available to the collective fell substantially after decollectivization. By 1983 collective funds for internal reinvestment were only half their peak level of 1979, and well below the levels of 1976-78.<sup>35</sup> In short, declining state and collective funding threw the burden of responsibility for agricultural investment onto the shoulders of the peasantry.

To a great extent of course, the foregoing trends were to be expected, since a key assumption of the reformers was that the peasants would increase their own investments to boost productivity in response to higher prices and greater marketing opportunities. But as it turned out, the peasants have been reluctant to invest in farming, especially agriculture. Agricultural output and productivity have both increased as a consequence of the responsibility system. But rising yields appear to have come less from increased productivity (via mechanization, etc.) than through simple intensification of the labor process -- basically, a nationwide speedup. Where once it

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<sup>34</sup> Lardy, op. cit., p. 95 and Table 2, p. 96.

<sup>35</sup> Ibid., p. 95.

required gongs, loudspeakers and cadres' orders to push the foot-dragging peasants out into the fields, farmers today, are up and working at dawn, and on their own account put in 12-16 hour days.<sup>36</sup> In addition, some farmers hold down industrial jobs in rural enterprises and do their farming chores in the mornings, evenings and weekends. But while output and incomes have risen, peasants have not, by and large, seen fit to plow much of their profits back into agricultural production. For the most part, as Hinton noted, the countryside is living off old capital -- there has been very little capital construction going on, few new terraces, dams, waterworks. And Hinton's observation is confirmed by official reports.<sup>37</sup> An article in the Party's theoretical journal

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<sup>36</sup> In his 1983 survey of Fenyang county, Anhwei Province, villagers told William Hinton that since the reforms they got up earlier, worked harder, stayed longer in the fields and accomplished more each day than they ever had under the old collective system. Former poor peasant and ex-beggar, Yang Ching-li, told Hinton, "In our cooperative days, we used to work all day, every day, year-in and year-out, but we got almost nothing done--work a little, take a break, work a little, take another break. We felt harrassed and we produced very little. What we were doing looked like work but in fact we were stalling around. Now we make every minute count. Our labor produces results. We earn a good living and we have time on our hands, lots of time." Monthly Review, November 1983, p. 7.

<sup>37</sup> In January 1984, Li Bening, Vice-Minister of Irrigation and Power Generation, remarked that "after the implementation of the responsibility system, maintenance works (of existing irrigation facilities) lag behind in some areas, and some were destroyed, and [this] has not yet been completely halted." Cited in Y.Y. Kueh, "Economics

Hongqi in 1983, for example, called attention to peasants' preference for consumption over accumulation. Since the implementation of the responsibility system, collective accumulation had dwindled to virtually nothing, said the journal.<sup>38</sup> Peasant earnings had increased sharply in recent years.

Yet, generally speaking, where the peasants' income has increased and their savings likewise increased, the portion converted to accumulation has been small and the conversion into expanded reproduction has also been small. In 1980, the increase in the volume of retail sales of the means of production for agriculture over the preceding year was less than 6.8%; in 1981, compared with 1980 figures and if we take into account the rise in prices, there was practically no increase at all. At the same time, in 1980, compared with the preceding year, the increase in production expenditures incurred by the communes, brigades, and teams was less than 3%, while in 1981, compared with 1980, there was actually a drop of 2% in production expenditures. All this shows the small amount of additional investment made. On the other hand, the scale of increase in the gross volume of retail sales of consumer goods in the countryside has been rather large. In 1980 and 1981, increases over

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of the 'second land reform," p. 131. The deterioration of agricultural waterworks, inland waterways and road transportation systems (all previously maintained in large part by collective requisitioning of labor) has also been noted by Lardy, "Agricultural reforms," p. 102; and David Zweig, "Opposition to change in rural China," Asian Survey, July 1983, p. 891.

<sup>38</sup> "A probe into the question of our country's present internal agricultural accumulation," by Sun Xiangjian and Pei Changhong in issue no. 9, May 1, 1983, pp. 21-24, JPRS July 6, 1983, pp. 37-44.

the preceding year were 33.8% and 15.7% respectively. These conditions illustrate that there was a rapid increase in consumption but a slow increase in accumulation. (emphasis added).

Peasant savings soared after the introduction of reforms, but the bulk of peasant investment has gone into housing and into consumer goods, not production. What productive investment there has been has tended to go not into agriculture but into rural industry, trade and construction.<sup>39</sup> The peasants' reluctance to invest in developing production, especially agriculture, stems from three sources. First, as noted above, the low profitability of farming by comparison with what peasants can earn in sideline production or in rural industries and trade, remains the principal disincentive to investment in agriculture. Secondly, even if they wished to invest in agriculture, parcellization of the land makes significant investments difficult because of reduced possibilities for introducing modern inputs, especially mechanization. As observers have pointed out, and as can be seen in Table 2.5 below, since the introduction of reforms the area of

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<sup>39</sup> According to one report, the total volume of new investment by peasant households in agriculture, forestry and animal husbandry declined by a third between 1984 and 1986, to less than Rmb 2 billion, while investment in industry, transport and construction climbed 61% to Rmb 14.1 billion. Far Eastern Economic Review, February 18, 1988, p. 69.



farmland under irrigation, the quantity of irrigated land served by mechanized pumping, and the use of tractors for land preparation -- all indicators of the extent of agricultural modernization -- fell in absolute terms between 1978 and 1985, in each case reversing long-term patterns of increase.<sup>40</sup> Even the production of pesticides declined by one-third from 1979-1983.<sup>41</sup> A measure of the reduction in scale of farming can be seen in the comparative growth rates for the production of large- and medium-versus small-sized and "walking" tractors. Production of the former peaked in 1984 and declined in 1985 (as did the production of combine harvesters), while production of small tractors more than doubled in the same aperiod. (Table 3.5). One important exception to this trend, however, was that peasants more than doubled their use of chemical fertilizers between 1978 and 1985 -- probably because application of these could be adapted to any size plot. Meanwhile, the government's original (1978) goal of mechanizing 85% of agricultural tasks by 1985 has been abandoned. In 1980, Zhao Ziyang, noted that while "we cannot use manual labor forever," and China will eventually

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<sup>40</sup> See Nicolas Lardy, "Agricultural reforms in China," pp. 97-8.

<sup>41</sup> Ibid.

have to mechanize agriculture, nevertheless, for the time being, because China lacks the resources to employ elsewhere the huge rural population that would be displaced by mechanization, "judging by present conditions, it is not an urgent and priority task to devote very great efforts to promoting mechanization. Since we have a large population, the labor force spared cannot be immediately absorbed elsewhere."<sup>42</sup>

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<sup>42</sup> "Study new conditions and implement the principle of readjustment in an all-round way," Hongqi no. 1, January 1, 1980, pp. 15-20, FBIS January 18, 1980, p. L 4.

**Table 2.5 Indices of Agricultural Modernization**

Year	1978	1984	1985	1986
1. Tractor-plowed area (million hectares)	40.7	34.9	34.4	36.4
2. Irrigated area (million hectares)	45.0	44.5	44.0	44.2
3. Proportion of power- irrigated area (percent)	55.4	56.4	55.9	56.6
4. Consumption of chemical fertilizers (million tons)	8.8	17.4	17.8	19.3
5. Large & medium-sized tractors (20+ horsepower) (x 1,000)	557	853	852	866
6. Small & walking tractors (x 1 million)	1.37	3.29	3.82	4.53
7. Combine harvesters (x 1,000)	18.9	35.9	34.6	30.9

Source: State Statistical Bureau, Statistical Yearbook of China 1986, pp. 109, 111; Statistical Yearbook of China 1987, pp. 110, 111.

Finally, despite the government's repeated reassurances to the contrary, the peasants know by long and hard experience that it is very risky to sink their capital into the land and other major means of production which could be confiscated in the next recollectivization, as they were in the 1950s and again in the 1960s. While the government extended the peasant's leasehold rights to 15 years in 1984 and has granted various concessions for reclaiming and improving land, still, officials complain that too many farmers remain "incredulous." "They are

afraid that all their [improved lands] will be taken over by the State and their efforts will be wasted if the government policies are changed."<sup>43</sup> By contrast, private housing had never been touched by collectivization, even during the Great Leap Forward and the Cultural Revolution.<sup>44</sup> So it was a natural field for peasant private investment. Since the early 1980s, peasant investment in private housing has been many times the amount of state investment in agriculture.<sup>45</sup>

#### D. Obstacles to Specialization, Diversification, and Commoditization of Agriculture

The implementation of the responsibility system also aimed to break down regional, local and peasant self-sufficiency and promote diversification and specialization by comparative advantage, and with it, greater commodity production and exchange. Yet this has not happened to any great extent. There is little doubt that abandoning the maoist policies of strict local foodgrain self-sufficiency

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<sup>43</sup> China Daily, October 12, 1988.

<sup>44</sup> This point is made very well by Professor Lardy in ibid., pp. 94-5.

<sup>45</sup> Ibid., p. 97.

and reopening rural and urban markets alleviated certain major distortions of past irrational planning.<sup>46</sup> In the effort to promote greater regional specialization by comparative advantage, the government, starting in 1976-77, adopted policies which guaranteed shipments of adequate supplies of foodgrains to specified growers of sugar, cotton, rubber, rapeseed, tropical fruits, and other noncereal crops in the provinces of Fukien, Shansi, and Hainan Island, which were better suited to produce these than grain. The government sought to induce these producers to specialize in economic crops in exchange for foodgrains at quota prices and also preferential supplies of fertilizer and other agricultural inputs. At the same time the government somewhat relaxed its control of interprovincial trade, permitting some development of informal (i.e. non-planned) long-distance trade between lower-level specialized producers and between provinces. Reopening the free markets also facilitated local specialization, especially in areas close to urban centers. These were important improvements, but for the most part they simply restored

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<sup>46</sup> Under the policy of local self-sufficiency in foodgrains imposed during the Great Leap Forward and more systematically, between 1965 and 1976-77, rural areas were permitted to produce economic crops only after they had achieved basic self-sufficiency in foodgrains. Lardy, Agriculture, p. 49.

the status quo ante that prevailed between 1949 and 1957, and again in the early 1960s, when specialization, commoditization and free markets were tolerated and even encouraged by government policy.<sup>47</sup>

Beyond this, despite considerable government promotion of the ideas of commodity production, exchange, and specialization by comparative advantage, there has been no broad shift in this direction in practice. Nor has there been any significant shift toward the allocation of resources by prices. Indeed, economists have argued that much if not most of whatever specialization has developed since 1978 is attributable less to the peasants' profit-maximizing response to changing market conditions than to revised government targets for quota delivery and sown area.<sup>48</sup> For example, after an initial upsurge, regional specialization and exports leveled off, and increasingly in recent years, the government has restricted supplies of grain to specialized producer areas, in effect reimposing a degree of local foodgrain self-sufficiency again (see below). Similarly, the government has given extensive sup-

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<sup>47</sup> Agriculture, pp. 48-9, 69-70, 94-7; Walker, "Chinese agriculture during the period of readjustment, 1978-83," pp. 793-4.

<sup>48</sup> Lardy, Agriculture, pp. 213-14; Walker, "Chinese agriculture," p. 794.

port to specialized households (zhuan ye hu), for example, giving specialized producers priority in allocation of agricultural inputs such as fertilizers and also in subsistence food grain for non-grain producers.<sup>49</sup> Yet despite these efforts, results have been very modest, and in particular, peasants have resisted specializing in grain production. The government reported that the marketed share of farm production rose from 51% in 1978 to about 60% by the end of 1984 -- a significant, but hardly dramatic increase.<sup>50</sup> In January 1985, the government reported that only 14% of peasant households had become specialized or even semi-specialized households (zhong dian hu), up from around 10% in 1980.<sup>51</sup> And this proportion may have actually declined in recent years.<sup>52</sup> Furthermore, such specialization and commodity production has overwhelmingly been concentrated in more profitable domestic livestock or poultry raising, whereas "only a few specialize in the

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<sup>49</sup> See eg. "Document No. 1, 1984," p. 134.

<sup>50</sup> China Daily, January 5, 1985.

<sup>51</sup> Xinhua, September 26, 1983; FBIS September 28, 1983 p. K2.

<sup>52</sup> See Robert Delfs, "Growing troublesome," Far Eastern Economic Review, February 18, 1988, p. 69.

cultivation of crops or in forestry and fishing"<sup>53</sup>

Many obstacles stand in the way of further commoditization and local and regional specialization. Despite the relatively restricted agricultural commoditization, in recent years the government has complained that "commodity circulation cannot keep up with the development of commodity production" -- that barriers to the free flow and exchange of commodities have become the principle obstacle to the development of rural commodity production.<sup>54</sup> Economists have pointed out that China's systems of food transport, storage, processing and marketing are far too weak to support extensive agricultural specialization and interregional exchange.<sup>55</sup> Even though the transport capacity of China's rail and highway networks have multiplied several-fold since 1949, this has not paved the way for increased specialization. This is because the transport network is not set up to facilitate interregional or even local, exchange. For example, a significant portion of the railway route struc-

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<sup>53</sup> Beijing Review, September 6, 1982, p. 3.

<sup>54</sup> Eg. "Document No. 1" (1984) p. 137.

<sup>55</sup> Eg. Lardy, Agriculture, pp. 204-10; Walker, "Chinese agriculture," p.801; and Lew Erisman, "The challenge," The China Business Review, (March-April 1986), pp. 20-4.



ture, and a large share of its capacity, is devoted to hauling coal from a few regions of concentrated production to urban centers of industrial and residential consumption. The share of total transport capacity allocated for agricultural products (foodgrains, perishable foods, and livestock combined) actually fell from just over 10% in the mid-1950s to less than 4% in 1979. By comparison, in India, such products accounted for 19% of rail freight alone in 1981.<sup>56</sup> Since the early 1960s, China's major cities, many of which are accessible by water transport, have depended on grain imports from the west for a substantial share of urban consumption. The transport system provides little scope for long-distance and/or large-volume exchanges between agricultural producers themselves. Likewise, China's food processing and storage, especially cold-storage, capacity could not absorb more than a miniscule fraction of specialized output.<sup>57</sup> Peasants have often complained that even when they produce

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<sup>56</sup> Agriculture, pp. 204-7.

<sup>57</sup> Ibid., pp. 207-8. The World Bank noted that as of 1985, China's rural road network is less than half the length of India's, there are fewer trucks per capita in rural China than in the impoverished Sahelian countries of West Africa; there is less cold storage capacity in the whole of rural China than in northwest India (with a population of just 50 million). China: Long-Term Development Issues and Options, p. 55.

marketable surpluses of perishables, they frequently rot because state agencies lack the capacity to process and store them. Consequently, the great bulk of output is still marketed locally, and even interregional grain shipments have only been permitted in a few exceptional cases, such as those mentioned above.<sup>58</sup> All this reflects a historical pattern of underinvestment in agricultural transport and marketing infrastructure. Clearly, a prerequisite to increased marketing is a massive increase in state investment in processing, milling, packaging, refrigeration, storage, transport, and so on -- all of which are far beyond the capacity of family farmers and crude rural village and township industries. Yet, as we noted above, state investment in agriculture has declined relatively and absolutely since the introduction of reforms.

In my view, state discouragement of marketing, and underinvestment in transport, processing and storage, only reflect what is by far the most important obstacle to specialization and commoditization. This is the reform leadership's determination to enforce planned agricultural production and surplus extraction, if necessary at the expense of all "economic" considerations. Indeed, Profes-

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<sup>58</sup> Ibid., pp. 208-9.

sor Walker noted with some surprise that in the very years (1978-79) that the government was implementing agricultural decentralization, it was simultaneously formulating a national land-use plan designed to more "scientifically" plan regional specialization.<sup>59</sup> Moreover, in his words, "there is little evidence that economic criteria such as comparative advantage have played a significant role" in the government's land-use plan, which instead was governed by the bureaucracy's own preferences and priorities.<sup>60</sup> From the perspective of a strictly cost/price maximizing logic, it might be more rational for China to specialize in the export of some crops and import others. For example, the World Bank has suggested that it would be more optimal for China to boost exports of rice (China is a relatively low-cost rice producer) and increase imports of animal feedgrains (which are comparatively expensive to produce in China) as a strategy for meeting changing domestic dietary demands.<sup>61</sup> But the reformers have resisted such specialization, preferring,

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<sup>59</sup> Walker, "Chinese agriculture," pp. 785-6.

<sup>60</sup> Ibid., p. 786.

<sup>61</sup> China: Long-Term Development Issues and Options, pp. 49-50.

as we noted above, the goal of overall national self-sufficiency in grain production. Not surprisingly, therefore, to meet its planned goals, in recent years the government has reimposed specific sown area requirements for grain and other crops, mandatory multi-crop cultivation, and compulsory double cropping in the south.<sup>62</sup>

The reformers' overriding concern to enforce the plan is also, in my view, the reason why prices have been allowed to play so little role in allocating resources. Despite repeated declarations about the need to rely more on economic levers such as pricing, in practice, prices have played little role since the introduction of reforms. With respect to grain, for example, Professor Lardy noted that the policy of stimulating larger deliveries of cereals through higher prices has been both more expensive and also less successful in quantity terms than originally hoped.<sup>63</sup> The 40-45% price increase paid to peasant producers for grain starting in 1979-80 caused huge government budget deficits since 1979 because the government, quite conscious of Polish events in 1980-81, chose to absorb the losses in the form of subsidies to

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<sup>62</sup> See e.g. China Daily, September 21, 1988; Beijing Review, February 8-14, 1988, p. 7.

<sup>63</sup> Lardy, Agriculture, p. 199.

urban consumers rather than attempt the politically risky course of passing them on to urban consumers. Yet for all its efforts, the price increase failed to increase the share of cereal output delivered to the state as taxes, quota deliveries, and over-quota deliveries. For example, between 1978 and 1981 output increased by 12% but the share delivered to the state increased only 10%.<sup>64</sup> This only reflects the fact that agricultural prices are still so depressed that even price increases of 45% were insufficient to elicit truly voluntary grain deliveries to the state. To elicit such free exchange, the government would have to pay the prices prevailing on the rural free markets, often twice the quota price. This may not be beyond the government's financial capability in an absolute sense, but given the bureaucracy's concern to concentrate its resources elsewhere, the reformers have resisted further quota-procurement price increases. So despite all the talk about the need to rely more on economic levers, in practice, since the early 1980s the state has reverted to the reimposition of mandatory quotas and sought to restrict both free trade in rural markets and

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<sup>64</sup> Ibid., pp. 199, 219.

informal barter.<sup>65</sup> The economist Terry Sicular has argued that, in reality, prices have never been the main determinant of agricultural output either before or since the reforms. Between 1978 and 1981, for example, the state raised the above-quota procurement prices for cotton by 56%, for grain by 45%, and for oil crops by 43%. Yet despite the premium incentive for cotton, oil crops -- whose procurement price increased the least -- recorded the greatest increase in both production and marketed output between 1978 and 1982, followed by cotton and then grain. Professor Sicular suggests that this and similar trends are explained by the fact that evidently, contrary to government statements, compulsory production and procurement quotas have not been lifted but have been enforced systematically right through since the start of the reforms and may even have been increased in recent years. Moreover, she says, the bureaucracy has shown a distinct preference for quantity planning because, apart from the high costs for the state of incentive procurement prices, with mandatory quantity and sown area quotas, the state does not have to guess which prices will elicit the

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<sup>65</sup> Ibid., pp. 198, 200, 208-10, 217.

desired output and procurement levels; it can insist on specific targets.<sup>66</sup>

**E. The Reformers' Dependence on the Bureaucracy and its Implications for Rationalizing Agricultural Production and Distribution**

One of the most important objectives of the reformers was to eliminate "bureaucratic interference" in agricultural production in order to raise the peasants' "enthusiasm for production."<sup>67</sup> With the shift to household contracting, the peasants gained considerable freedom to determine production. Yet, once again, given the conflict between the government's concern to enforce planned agricultural production versus the peasants' concern to maximize their incomes by producing the most profitable crops (or not to invest in production at all), the reformers came to regard the peasants' autonomy as excessive. Thus in recent years, in the effort to enforce the plan the reformers have moved to reinforce the power

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<sup>66</sup> Terry Sicular, "Rural marketing and exchange in the wake of recent reforms," in Perry and Wong, eds., The Political Economy of Reform in Post-Mao China, pp. 91-2, 97-103, 107-8.

<sup>67</sup> See the 1978 "Decision on Accelerating Agricultural Development," op. cit..

of the basic-level cadres and the entire rural bureaucratic apparatus. In the context of the responsibility system, party and cadre domination of the countryside is exercised mainly through the local cadres' power of allocation. The central bureaucracy's power to enforce its agricultural plan is crucially dependent upon the basic-level cadres' power to enforce specific cropping patterns and quota deliveries. Since the implementation of reforms in 1978-79, the central government has issued fewer mandatory targets, but "advisory" targets have still continued to specify sown area for priority crops such as cotton and sugar.<sup>68</sup> But even where specific targets for sown area and crop deliveries are not mandated, the cadres have often been able to enforce compliance with the government's plan by other means. Although the basic-level cadres, production team leaders, no longer directly manage production and distribution (eg. no longer specify cropping patterns, hand out daily labor assignments, or divide up the surplus by workpoints), team leaders still exercise substantial control over production through their power to allocate contracts, contract land and private plots, and

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<sup>68</sup> Walker, "Chinese agriculture," p. 785.



agricultural inputs such as fertilizer.<sup>69</sup> To the extent that local cadres have the power to allocate state contracts and contract land for specific crops, this gives them the power to determine to a great extent which peasant families will have the greatest opportunities to benefit from the most profitable crops.<sup>70</sup> Similarly, although the reformers once envisioned abandoning state rationing for the main agricultural inputs such as chemical fertilizer and fuel, documents indicate that the state intends to continue the system of rationing these key inputs.<sup>71</sup> State power to assign crop and land contracts and to ration inputs are explicitly designed to compel the

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69 The persistence and vicissitudes of party cadre power in the countryside has been the subject of several interesting articles. In particular, see two articles by Jean Oi: "Communism and clientelism: rural politics in China," World Politics, January 1985, pp. 239-66; and "Peasant households between plan and market, cadre control over agricultural inputs," Modern China, April 1986, pp. 230-51; and two articles by David Zweig, "Opposition to change in rural China," Asian Survey, July 1983, pp. 879-900; and "Prosperity and conflict in post-Mao rural China," China Quarterly, no. 105 (March 1986), pp. 1-18. See also Richard J. Latham, "The implications of rural reforms for grass-roots cadres," chapter 6 of The Political Economy of Reform in Post-Mao China, pp. 157-73.

70 Oi, "Communism and clientelism," pp. 240-1, 255, 265; and idem. "Peasant households," esp. pp. 233-36.

71 Oi, "Peasant households," p. 240.

peasants produce certain crops and to sell their output to the state. Moreover, peasants can obtain coupons for additional allocations of state-priced fertilizer for the sale of over-quota produce to the state. In theory, peasants can get around the rationing system, by purchasing fertilizer and fuel on the free market. But free market prices for these items are often at least double the state price. Because this is prohibitively expensive for all but the most prosperous producers, peasants have often chosen to sell their surplus to the state, even when they could get higher prices on the free market.<sup>72</sup> In short, the government's determination to enforce the plan against the market has reinforced the power of the "vertical" apparatus of rural administration from top to bottom. Unavoidably therefore, this has reinforced the bureaucratic barriers to free commodity production and "horizontal" exchange which the reform leadership claims it wants to promote. Furthermore, enforcing the plan necessarily means sacrificing economic considerations, such as the most optimal cropping patterns, etc., to political concerns -- again just the sort of problem the reformers hoped to resolve by relying on the market.

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<sup>72</sup> Oi, "Peasant households," pp. 235-6.

The center's continued dependence on the local cadres to enforce the plan has other negative implications as well. For it only aggravated instead of alleviating problems of cadre abuse of power and corruption, which have long been burdensome to the peasantry. Decollectivization eliminated many of the supervisory jobs (eg. work-point recorder, cashier, storekeeper) and so meant a cut in salary for many base-level cadres and unemployment for some.<sup>73</sup> By and large however, the cadres' remaining powers of allocation, and the continuation of rationing has transformed many cadres from direct economic managers into petty brokers, and opened up new avenues of self-enrichment. Most obviously, in a system in which the cadres have the power to allocate contracts and land, they naturally don't forget to distribute the most lucrative contracts and the best land to themselves and their families. In one study, anywhere from 40-85% of the newly wealthy peasants were brigade and team cadres or former cadres.<sup>74</sup> Also, in recent years there have been numerous

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<sup>73</sup> The negative economic impact of the responsibility system on cadres at the team and brigade levels has been described by Richard J. Latham in "The implications of rural reforms for grass roots cadres." See also, David Zweig, "Prosperity and conflict," p. 5.

<sup>74</sup> Zweig, "Prosperity and conflict," pp. 4-5.

complaints in the press about local cadres harassing entrepreneurs by levying various petty arbitrary and illegal taxes and surcharges on private businesses, demanding "samples" of produce, and extorting "loans" from newly rich peasants as protection and in return for crucial rations.<sup>75</sup> Likewise, the emergence of a two-tiered price structure with the post-1978 reforms has presented unscrupulous cadres (and others) with manifold opportunities for speculation and profiteering (touji daoba). There have been widespread reports, for example, of cadres skimming off fertilizer and fuel, which was paid for at state prices, and reselling these on the free/black market at substantial profits to themselves.<sup>76</sup> In sum, throughout the countryside, corruption has expanded in direct relation to the decentralizing reforms -- to the detriment both of economic rationality and central planning. (See Chapter 4 below).

### III. THE DOWN SIDE OF THE MARKET: SOCIAL REALITIES OF RURAL CAPITALISM

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<sup>75</sup> Many of these are detailed in the two articles by Jean Oi cited above, and in David Zweig, "Prosperity and conflict," pp. 5-6.

<sup>76</sup> Jean Oi, "Between plan and market."

Finally, to the extent that the reforms have succeeded in fostering marketization, they have also entrained many of the less attractive features of capitalist economies in the West, and these too present big problems for the bureaucracy and its efforts to rationalize the economy.<sup>77</sup> Since the start of the agrarian reforms the press has increasingly complained that in the headlong scramble to exploit public resources for private advantage, grasslands have been plowed up to raise cash crops, mountains stripped, forests denuded, farmland illegally occupied to build houses, trees and even telephone poles indiscriminantly felled (for lumber for housebuilding and furniture). Collective resources have been plundered, infrastructure has deteriorated, and the environment has suffered.

To begin with, decollectivization created a host of problems related to agricultural production. The most important of these has been the tendency of individual peasants to maximize their short-term gain at the expense of the long-term and collective needs of the peasant economy as a whole. We already noted above one important instance of this, the deterioration of the agricultural

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<sup>77</sup> Thomas Bernstein surveyed many of these "unintended consequences" in his "Reforming Chinese agriculture," The China Business Review, March/April 1985, pp. 45-9.

infrastructure, especially irrigation works. Another problem has been the increasing overexploitation of the land, especially the remaining collectively held land, but also privately leased land. For example, William Hinton reported that in the northern grasslands regions where he worked, decollectivization precipitated a free-for-all that has put the environment, productive resources and the social structure in jeopardy. The privatization of much of the livestock herds put tremendous pressure on the rangeland (which remains collectively owned) as herders strove to maximize the size of their individual herds, and maximize their own herd's share of the pasture at the expense of others. The government has complained that in the "fight for grassland between privately owned and collectively owned livestock," herders "swap their small animals for bigger ones, males for females, thin ones for fattened ones, or dead ones for live ones to the detriment of collective interests."<sup>78</sup> Hinton found that it often proved impossible to reseed the more and more overburdened pastures, as herders broke down the fences to let their herds get access to the new seedlings. The predictable consequence, he said, is that many grasslands became over-

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<sup>78</sup> Nongye Jingji Wenti (Problems in Agricultural Economics) February 23, 1983, pp. 51-53, JPRS no. 84269, September 7, 1983, p.44.

stocked to the point of disaster, and masses of animals died off as a result. Hinton further reported that officials have been extremely reluctant to intervene and restrain the peasants from ripping off the collective resources -- for fear of being attacked for imposing "leftist restrictions." His observations seem to be corroborated by official criticisms of herdsmen for fighting over grassland and "taking more than replenishment," and by recent calls for recentralized management of the pastures.<sup>79</sup>

Equally predictable, the original equal shareout of the herds that made everyone prosperous the first year, in short order brought social polarization, class formation, and inevitably impoverishment for many, as families that originally got perhaps twenty head of livestock, were

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<sup>79</sup> Thus a prominent agricultural journal warned that "The grazing load of the pastoral regions is limited. When livestock expand beyond what the grasslands can bear, the law of ecological balance will restrain their expansion (not only the privately owned but also the collectively owned livestock). Otherwise the working of vicious cycles will lead to the decline and ruination of production. The overtaxed grasslands in some localities have begun to degenerate and affect the quality of livestock. It is necessary to introduce planning to grassland construction and livestock development. A state of anarchy must not prevail." Nongye Jingji Wenti, February 23, 1985 pp. 51-53, JPRS no. 84269, September 7, 1983, p.45.

eventually reduced to only to a few, and some none at all, while others accumulated substantial herds. Privatization also hindered epidemic control and because livestock dipping and vaccinations were put on a for-fee basis. This put the heaviest burden on the the poorest families, but was detrimental to the entire rural community. In one Inner-Mongolian district, veterinary services disintegrated, leading to decimation of livestock.<sup>80</sup> Similarly, in the agricultural regions, peasants have tended to overexploit contracted land and systematically rip off collective resources. To a great extent, this was exacerbated by the short two-to-three year leases granted by the initial reforms. The extension of contract leases to 15 years in 1984 was explicitly designed to overcome this problem and arrest the decline in soil fertility, yet as noted above, the peasants remain reluctant to invest in the land.<sup>81</sup>

Decollectivization has also, to a great extent, gutted rural social services. Collective provisions for the care of the elderly, incapacitated and others in need, has substantially broken down and the government is vague

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<sup>80</sup> Bernstein, "Reforming Chinese agriculture," p. 47.

<sup>81</sup> See "Document No. 1 (1984)," op. cit., p. 133.



about how these are to be funded in the future.<sup>82</sup> Rural public health care, once the pride of the revolution, has seriously deteriorated as medical clinics have been forced to dissolve and doctors sent into private practice. One consequence of the decline in medical care is that life expectancy in China appears to have fallen slightly since 1978, reversing two decades of improvement. This is evidently attributable to the upturn in the infant mortality rate.<sup>83</sup> Also, many public schools have been put on a for-fee basis instead of being supported out of collective funds, with the result that, as under the ancien regime, education has increasingly become the privilege of the rural elite. As a consequence of this and peasant strategies to maximize income by employing their children, rural primary school enrollment rates have dropped in recent years.<sup>84</sup>

**Free to Lose:  
The New Economics Revives the "Four Olds"**

As increasingly, Deng's brave new world more than superficially resembles the old society, there has been a tremendous recrudescence of old culture, old customs, old

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<sup>82</sup> See e.g. "1984 Document No. 1 (1984)," op. cit., pp. 138-9.

<sup>83</sup> Lardy, "Agricultural reforms," p. 101.

<sup>84</sup> Ibid.

superstitions and pre-revolutionary forms of oppression. Child labor, prostitution, gambling, gang violence, and other manifestations of feudal and bourgeois life, once virtually abolished, are all on the rise again.<sup>85</sup> Growing social polarization, especially in the countryside, has forced tens of families into indebtedness and poverty for every wanyuanhu. A signal register of this trend is the report that malnutrition and obesity are both on the rise among children.<sup>86</sup> The Dengists' slogan was "let some peasants get rich first" (rang yixie nongmin xian fugilai). While the official press gave prominence to the rural well-to-do, there are numerous indications that the rural poor are not only failing to successfully "emulate" the rising rural bourgeoisie, but are falling ever further behind.<sup>87</sup> While China's official press has criticized the

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<sup>85</sup> See John Fitzgerald, "Deng's development drive and the dawn of decadence," Far Eastern Economic Review, April 5, 1984, pp. 44-45; and Elizabeth J. Perry, "Rural collective violence: the fruits of recent reforms," in The Political Economy of Reform in Post-Mao China, pp. 175-92.

<sup>86</sup> China Daily, November 3, 1988.

<sup>87</sup> On the persistence of poverty see e.g. Nick Eberstadt, "Material poverty in the People's Republic of China in international perspective," in Joint Economic Committee of Congress (J.E.C.), China's Economy Looks Toward the Year 2000, (Washington D.C. U.S. Government Printing Office, 1986), pp. 263-324.

nouveaux riche rural bourgeoisie for extravagant and wasteful spending on weddings, funerals, feasting, and on "all kinds of luxuries,"<sup>88</sup> millions upon millions of poorer peasants have abandoned unprofitable farming, fallen into debt, or in other ways lost their land, and joined the mass exodus of migrants to the cities.<sup>89</sup>

#### **Flight From the Land and the New Unemployed**

By late 1986, Beijing, with a permanent population of some 6 million, had 1.2 million registered migrants and was absorbing some 100,000 new residents each year. The influx into Shanghai and Guangzhou has been even higher. It has been estimated that by early 1988 some 50 million peasants had flocked to the cities and towns, and the number of unregistered illegals is unknown.<sup>90</sup> The flood of new arrivals has placed an enormous strain on urban housing and social services, and for most of these new

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<sup>88</sup> E.g. China Daily, September, 1, 1988, October 10 & 18, 1988.

<sup>89</sup> E.g. see Christopher S. Wren, "Despite rural China's gains, poverty grips some regions," New York Times, December 18, 1984; Robert Delfs, "A model of poverty," Far Eastern Economic Review, September 10, 1987, pp. 83-5.

<sup>90</sup> Sandra Sturdevant, "China's new labor market," The Nation, November 28, 1988, p. 561; Lei Xilu, "Diversified economy attracts surplus labourers," Beijing Review, November 24, 1986, pp. 16-18; A. Laquian, op. cit.; and Woodward and Banister, op. cit., p. 14.

migrants, and especially for the illegals, there is no iron rice bowl -- no guarantees of employment, no medical or pension benefits, no state-provided housing or schooling for their children. Most of the males in this vast "floating population" (liudong renkou) seek employment in construction, haulage, trade and services, and rural township industries. Well-to-do urban families now hire some of the migrant women as domestics or nannies.<sup>91</sup> Others find no work and turn to prostitution. Venereal disease, once substantially suppressed, is now spreading rapidly, especially in southern China.<sup>92</sup> As social services have been dismantled in the Reaganite privatization of recent years, pawnshops -- once emblematic of the rentier parasitism of the ancien regime regime, and closed after the revolution -- have reopened.<sup>93</sup> And free

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<sup>91</sup> "Beijing families hunt for domestic staff," China Daily, November 25, 1988.

<sup>92</sup> See Edward A. Gargan, "Newest econommics revives the oldest profession," New York Times, September 17, 1988.

<sup>93</sup> According to one pawnshop owner: "We were determined to create a new image . . . We put it ahead of making money in order to help tide people over on rainy days. Our pawnshop is not quite the same as those in the old China which profiteered from auctioneering the underpaid pawns. We give out short-term pawn loans to those who badly need money but have no access to bank loans." China Daily, May 30, 1988.

marketeers can't deny that they too provide a useful "service," given the lack of alternatives.<sup>94</sup> For those with nothing left to pawn, they're now free to beg, and the increasing numbers of homeless and impoverished beggars on Chinese streets have shocked foreign visitors and caused official concern. Officials have also decried the increasing utilization of child labor by small-time private entrepreneurs. Child workers are said to account for about 20 percent of the workforce in the (largely unregulated) rural township enterprises.<sup>95</sup> But, again, given the increasing economic pressures (especially inflation) on families, and given the reformers' own advocacy of "deregulation," such exploitation is likely to grow, as are other abuses.

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<sup>94</sup> Sandra Sturdevant noted that the reformers have tended to resist the extension of medical, accident and pension benefits to the new migrant workers as "excessive social welfare burdens," that its firms "need to be free from in order to improve their market competitiveness." loc. cit., p. 561. Thus, not surprisingly, the government has recently called for privatization of such programs. According to one official: "Social old-age welfare programmes should be financed not only by the State and collectives but also by individual families." China Daily, October 24, 1988.

<sup>95</sup> See e.g. Hu Sigang and Yu Faming, "Crackdown on hiring of children by enterprises," China Daily, November 5, 1988.

### **Women Take Another Beating**

The special oppression of women has also distinctly escalated with the institution of the new economic policies. Most importantly, the privatization of farming combined with the passage of a draconian birth control law has virtually instituted coerced birth control and forced abortions, and has been responsible for the revival of female infanticide, also once virtually abolished in China. In 1979, China passed a birth control law that limits families to one child.<sup>96</sup> But privatization of agriculture with its concomitant breakup of collective social services put tremendous pressure on farm families to have more, especially male children. With the reversion to family farming, the potential of gain held out powerful economic incentives to families to have more children to add to the farm labor force. At the same time, the gutting of rural collective social services put additional pressure on families to raise more children to support them in their old age. Consequently, after dropping steadily for nine years from 2.4 percent in 1971 to 1.1 percent in

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<sup>96</sup> See John S. Aird, "Coercion in family planning: causes, methods, and consequences," in China's Economy Looks Toward the Year 2000, pp. 221; and Joyce K. Kallgren, "Politics, welfare and change: the single-child family in China," in The Political Economy of Reform in Post-Mao China (1985), pp. 131-56.

1979, the birth rate turned back upward and by 1987, according to the State Statistical Bureau, the birthrate had reached 2.1 percent.<sup>97</sup> The government insists that the peasants are motivated by "backward ideas" in their desire for big families. Yet, it is apparent that, under present conditions, a one child policy holds disastrous practical and material implications for peasant families. Since health care, schools, etc. are increasingly privatized, peasants must look to the family to support these needs, so it pays to have more productive members to assume care of those who cannot fend for themselves, i.e. the young and the old and infirm. Since the government provides no old-age benefits for the peasants, parents must rely on their sons to support them when they can no longer work (when daughters marry they are subsumed into their husband's families and so can only contribute to the support of his parents). A one-child policy therefore puts tremendous pressures on families to have a boy. Predictably, this resulted in a sharp rise in female infanticide, as not only Steven Mosher's controversial investigation reported, but published Chinese official sources have revealed. In 1982, Chinese newspapers reported that in

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<sup>97</sup> Cited in Ellen Salem, "Procreating for profit," in Far Eastern Economic Review, June 25, 1987, p. 57.

some rural communes, only 200 out of every 500 infants who survive were female.<sup>98</sup> A study of their own and a neighboring province by the Anwei Women's Federation compared the number of children born in 1979 before the population-control measure went into effect, with the number born in 1981. In 1979, 11,522 children were born in the two provinces of which 51.6% were boys and 48.4% girls, a ratio close to the national average. In 1981 there were 10,767 births and the sex ratio was strikingly different: 6,266 (58.2%) were boys and only 4,501 (41.8%) girls. Using the 1979 ratio, 5,211 girls should have been born in 1981. Since 709 fewer were actually born, the federation concluded that this is the number likely killed at birth.<sup>99</sup> A corollary effect is that by the time this gen-

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<sup>98</sup> See Jonathan Mirsky, "The infanticide tragedy in China," The Nation, July 2, 1983, pp. 12-14, and the sources cited therein.

<sup>99</sup> Ibid., p. 13. As a result, bride prices, arranged marriages, and increasingly elaborate weddings are once again on the rise. Nick Eberstadt noted that results from the 1982 China census revealed an unexplained deficit of at least 200,000 baby girls for that year, which he also concluded was caused by female infanticide. Eberstadt further reported that U.S. Census Bureau studies concluded that the life expectancy of Chinese women may have dropped by several years since the population control campaign began. Death rates appear to be up for women of child-bearing ages which the Bureau suggests may be explained by the fact that women seeking to circumvent the one child rule must now avoid all health care facilities, and are thus bereft of all medical assistance. "Peking's family policy," The New York Times, April 22, 1984.



eration matures, close to two thousand of those men will be unable to find wives and so be unable to marry. Who will support them in their old age?

**Reformers' Priorities and the Canard of "Demographic Disaster"**

In the meantime, in an unending stream of editorials, articles, and speeches, Chinese officials have warned, in no uncertain terms, of impending demographic disaster if China's birth rate is not brought down -- by whatever means.<sup>100</sup> Moreover, such dire Malthusian predictions have typically been rehearsed as self-evident by social scientists and commentators in the West. New York Times columnist Anthony Lewis, for instance, recited the conventional wisdom as follows (August 29, 1985):

There are well over a billion Chinese now, 22 percent of the human race living on 7 percent of the world's arable land. The official aim since 1979 has been to slow the increase so that the population reaches 1.2 billion in the year 2000 and then grows no more. The policy may well fall short, not because of outside pressure but because it conflicts with human instincts. And what then? It is hard to foresee anything but a Malthusian struggle in the most literal sense: a struggle to divide exhausted resources, a

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<sup>100</sup> See for example, Vice Premier Chen Muhua's statements in the China Daily of January 31, 1982; and Chairman of the State Family Planning Commission, Wang Wei's remarks, also in the China Daily, of December 6, 1985.

struggle for life.

Nevertheless, the evidence for this interpretation is, to my mind, extremely dubious. For ironically, the threat (in fact, the actuality) of population outstripping resources was a problem of the Mao period rather than today. Under Mao, grain production at best barely kept pace with the population growth and even, at points, fell below it. By contrast, since 1978 while population growth has gradually risen from 1.1 percent to 2.1 in 1987, grain output has increased at an average annual rate of 3.1 percent -- or 50 percent greater than the highest rate of population increase since the reforms. And grain output, it should be noted, has registered the slowest rate of growth; the output of many foods has multiplied several fold since 1978. Moreover, Lewis published the above-quoted Op-Ed piece before the reduced harvest of 1985 had come in. Up until that time, viz. between 1978 and 1984, grain output had grown at an average annual rate of 4.9 percent, or roughly four times the then current rate of population increase. Even since the 1985 dropoff, grain output has still outpaced population growth. In 1986 and 1987 grain output grew by 2.7% per year, or 27% faster than the highest rate of population increase in these

years.<sup>101</sup> In sum, the reformers certainly face considerable problems in agriculture (many of their own making), but China today is hardly faced with "a struggle to divide exhausted resources."

As I see it, there is no objective problem of population outstripping resources in China. But there is a very big subjective problem of the distribution of relatively growing resources. As one official critic recently put it: "If the country could spare 17.7 percent of total capital investment on agriculture in the early 1960s, when the republic faced far greater economic difficulties, the inability to save a little more for agriculture today is inexcusable."<sup>102</sup> In his first book on rural China, Steven Mosher quotes a Communist Party commune cadre explaining the government's population planning program to the assembled women of Sandhead Brigade, as follows:

We know that you want a son in order to be secure in your old age. But remember that you are still young. As the country develops, it will create welfare programs. By the time you are old, you will not have to worry about who is going to support you. The government will support you.

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<sup>101</sup> Percentage figures for the growth rate of grain output are derived from Table 3.2 above.

<sup>102</sup> Vice-Premier Tian Jiyun, quoted in the China Daily of November 19, 1988.

Yet, instead of increasing, the government has sharply cut spending on agriculture and on rural social services -- a fact which was no doubt all too evident to those assembled women.<sup>103</sup> The problem, in other words, is that it has been a political decision by the ruling bureaucracy not allocate resources for old-age benefits for the peasantry but instead to concentrate them on its own agenda: like pouring billions of dollars into showcase projects like Shenzhen in a largely futile effort to attract high-tech multinational investments. Resources could quite probably be found to pay the peasants more for their crops, and to fund necessary social services, if the ruling class weren't squandering its resources on industrial showcase projects that only run half the time, on jumbo jets and tiger tanks, on splashy hotels and resorts, and not the least, on its own shamelessly extravagant consumption. How many old-age pensions, for example, could have been paid for by the central government's single purchase in 1985 (with ceremony yet!) of 20 Cadillac stretch limousines, each outfitted with a built-in television set, refrigerator and bar. At some \$39,000 apiece, each cost the equivalent of about 115 years wages for the average

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<sup>103</sup> Broken Earth, The Rural Chinese, (New York: Macmillan, 1983), p. 225.

industrial worker.<sup>104</sup> In its report the New York Times noted that Chinese officials were "evasive" about which "state leaders" would be using them. But Deng Xiaoping, who likes to preach to the masses about the need to cut out waste and extravagance so as to conserve resources for the Four Modernizations, is said to prefer a Mercedes-Benz for his own travel.<sup>105</sup> As we shall see in Chapter 4, this example is not at all untypical of the priorities and spending patterns of the party-bureaucracy as a whole. In sum, to put it bluntly, it is less the lack of resources than the grandiose schemes and greed of the ruling party-bureaucracy that condemns the peasantry to fend for themselves by the only means they have available, viz. pursuing a strategy of having more male children, even at the cost of female infanticide.

#### IV. WITHER RURAL CHINA?

With the slowdown in the growth of grain production, the reformers are having second thoughts about decollectivization and privatization. It is now apparent that the benefits of the reforms since 1978 are largely exhausted,

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<sup>104</sup> See John F. Burns, "In China, 'Capitalist Roaders' can now cruise in Cadillacs." New York Times, June 29, 1985.

<sup>105</sup> Ibid.

and that future gains in yields and output will have to come through agricultural modernization, especially mechanization. There is also general agreement that this will require, as a first step, a "moderate concentration of land . . . so that farmers can obtain greater returns from production on a larger scale."<sup>106</sup> Yet the main impediment to land consolidation is precisely the land reform measures of 1978-84. Successive Central Committee decisions over these years strengthened the peasants' possession of the land and discretionary power over its use.<sup>107</sup> At the same time, the reformers also encouraged

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<sup>106</sup> "Restrains linger in grain production," China Daily editorial of September 26, 1987. See also, Cao Yong, "Concentrating farm plots seen as way to up yields," China Daily November 5, 1988; and Edward A. Gargan, "Across the Chinese countryside, the watchword is think big," New York Times, April 3, 1988.

<sup>107</sup> Central Committee "Document No. 75" of September 1980 legitimized the most radical form of household contracting, on a limited scale. See the "Communique on Some Problems Relating to Further Strengthening and Implementing Agricultural Production Responsibility Systems," in Zhongguo Nongye Nianjian 1981 (Agricultural Yearbook of China, 1981), pp. 409-11. Central Committee "Document No. 1" of 1983 legalized the sale of agricultural means of production including trucks and large tractors, to private individuals. Even more significantly, the same document legalized relatively unrestricted hiring of wage labor. See "CCP Document No. 1 on Rural Economic Policies," FBIS April 13, 1983, pp. K6-7. "Document No. 1" of 1984 extended the length of leases for contract land from the 2-3 years stipulated in earlier regulations, to 15 years (or more in the case of orchards, forestry, and reclamation), and permitted, in theory at least, virtually unlimited transfers of leasehold rights with all compensatory provisos -- in effect, permitting unlimited renting of land. That document also reaffirmed the 1983

the growth of sideline production and rural industrialization in the hopes of promoting greater specialization. Since state controlled prices have kept farming so unprofitable, peasants naturally sought to find industrial or commercial jobs, since nearly anything pays better than working the land, and as a result, the hoped-for "grain bases" never developed. Yet, paradoxically, the reformers have been frustrated by the refusal of many of these peasants to give up or even lease the land to others who would farm it more efficiently, even though they themselves no longer work it. Officials complain that much land contracted out to individual families has been poorly tilled or left fallow.<sup>108</sup> In many instances taxes are so low that peasants prefer to pay them and hang onto the land. Even where more than 90 percent of the farmers have

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provisions on wage labor. See "CCP Document No. 1 (1984)" in op. cit., pp. 131-42. Outright land sales were still prohibited by these documents, but the security of lengthy of leases, combined with what are frequently rather modest rents (i.e. relatively low fixed delivery quotas), has made it more difficult for the government to get the peasants to give up land for reallocation, by the collective, to meet the needs of the state plan. Some of the problems posed for the state by extended leaseholds is discussed by Y.Y. Kueh, in "The economics of the 'second land reform,' " pp. 128-9.

<sup>108</sup> Cao Yong, op. cit.

taken up non-agricultural occupations, many still refuse to give up the land.<sup>109</sup> In short, land reform, initially the spur to increased output, failed to resolve the basic contradictions of the system and has itself become a fetter on further development.

Land consolidation could conceivably come about only through one of three methods: either (a) through voluntary collectivization, with peasants merging their mini-plots into consolidated farms, or (b) through forced collectivization, or (c) through the development of capitalist farming based on the expropriation of peasant proprietors. Each alternative poses different, but formidable difficulties for the reformers. With respect to the first, the peasants could only be persuaded to voluntarily consolidate and rationalize their dispersed plots if this would be in their economic interest, that is, if the state would decontrol or sharply raise its purchase prices for marketable output. Since the reformers show little inclination to make these necessary adjustments, voluntary reconcentration seems unlikely.<sup>110</sup> Forced recollectiviza-

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<sup>109</sup> China Daily, October 19, 1988.

<sup>110</sup> In recent years, the government has tried to encourage peasants to consolidate their fragmented plots into large-scale mechanized farms run by specialized grain-growing farmers, by setting up "model" farms. But as Professor David Zweig has pointed out, such models are viable only because county governments have heavily subsidized these operations with loans or grants of equipment and extra chemical fertilizer. Peasants he interviewed in 1986



tion is obviously vastly more problematical in political terms, and so probably even more unlikely. That leaves the third alternative, the capitalist road.

All the government's efforts at rural reform -- decollectivization, leasehold security, encouragement of specialization, deregulation of prices -- logically tend in the direction of resurrecting agrarian capitalism. This would certainly offer one way out of the economic impasse. The displacement of small-scale family farming by large-scale capitalist agriculture would open the way to increases in productivity and output through specialization, economies of scale, and capital intensification, especially mechanization. Yet the development of agrarian capitalism would also pose huge threats to the bureaucratic reformers and their goals. First and foremost, should market forces really come to dominate agricultural production, the reformers would find it very difficult, if not impossible to enforce their agricultural

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lacked the capital to pay for such modernization, and in any case, "still mistrusted the policies, fearing that hiring labor would bring future troubles." Consequently, land transfers have occurred very slowly. Zweig estimates that as of 1986, probably not more than 4 percent of total land had changed hands. (Zweig's comments were contained in a letter to the editor of the New York Times of April 25, 1988, in response to the article by Times correspondent Edward A. Gargan cited in footnote 41).

plan. Secondly, consolidation and concentration of the land would inevitably entail the expropriation of many, and ultimately the great mass of the peasantry from the land. True, government officials have stated that they want to shift from a third to half of the rural labor force out of agriculture and into rural industries by the year 2000.<sup>111</sup> But at present, since urban large-scale industry is already massively overstaffed, and since rural village and township industries are also having difficulties absorbing the millions of school leavers who enter the workforce each year, Chinese officials and Western analysts are dubious that these can really absorb such a huge number of peasants.<sup>112</sup> Thirdly, and closely related to the last point, political considerations also strongly militate against letting rural social polarization proceed very far. As we saw, the Dengists' rich peasant policy has not, as we noted above, provided the means by which the less entrepreneurial, less diligent, less skilled, and most importantly, undercapitalized and/or overburdened peasants will ever "catch up" with the leaders. Besides these

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<sup>111</sup> See eg. Du Rensheng's comments in Beijing Review, June 24, 1985, p. 17.

<sup>112</sup> For example, see Professor Nicolas Lardy's remarks in "Agricultural reforms in China," p. 100.

obvious differentials, in the context of a part-plan-part-market system, "success" often depends less on ability than on government policy with respect to prices, inputs, and so forth. This is all the more so since official government policy (eg. Document No. 1, 1984) explicitly favors specialized households by providing them priority allocations of seeds, fertilizer, fuel etc. Others can also become rich but, as one peasant told an investigator, "it is more difficult." Whereas ordinary peasants are always short on supplies, specialized households always receive needed inputs, often at cheaper prices, sometimes paying only half the regular price.<sup>113</sup> The inability of ordinary grain farming peasants to "make it" has, of course, been the main impetus to rural flight from the land. And this increasing rural mobility itself presents formidable problems to the reform leadership. On the one hand, freer mobility in the context of vastly different economic opportunities between industrial and agricultural pursuits makes it increasingly difficult for the leadership to enforce its agricultural plan, especially grain production. On the other hand, the government is totally unprepared to provide food, housing, and services for a really massive influx into the cities. It is hardly sur-

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<sup>113</sup> Jean Oi, "Peasant households," op cit., p.241.

prising, therefore, that, in line with the massive recentralization and industrial cutbacks of announced in the fall of 1988, the government has finally moved to begin expelling masses peasant migrants from the cities and towns. According to the China Daily (November 23, 1988), "Since last year over a million are estimated to have been forced back to the land and even more are expected to be affected next year." It is a measure of the reformers' doubts, fears, and confusion about the market strategy that while plunging ahead with some reforms, and tolerating a substantial development of capitalist agriculture on the periphery, the reformers have simultaneously moved to block the development of full-fledged capitalist agriculture by refusing to deregulate prices, by enforcing the state monopoly on purchase and supply for the bulk of output, by curtailing the market and reimposing restrictions on mobility.

To sum up, with respect to agriculture, the post-Mao shift to a market socialist strategy overcame certain of the contradictions of the maoist collectivist strategy -- only to pose new and equally problematical contradictions in their place. In the last analysis, Deng's market reform strategy suffers from the same overarching liability as Mao's strategy -- it aims to be both developmental and extractive at once, and cannot, because any substantial increase in agricultural output and productivity requires

the industrialization of agriculture, which in turn, presupposes massive investments in agriculture. Given the reformers' refusal to do this, because of their preference for investment elsewhere, the hoped-for modernization of agriculture by the year 2000 will have to be postponed to the next century.

## CHAPTER 3

### THE PERSISTENCE OF ECONOMIC IRRATIONALITY IN THE INDUSTRIAL SECTOR

The initial wave of industrial reforms from mid-1978 through the fall of 1980 unleashed a burst of economic activity, much of which brought several immediate and dramatic improvements. By far the most striking improvements brought by the reforms have come in the areas of income gains, increases in light industrial output, expanded urban services, and expanded foreign trade. After decades of stagnating and even declining living standards, the real wages of workers and staff in state-owned industrial units rose by 34% from 1978-1985.<sup>1</sup> When significant non-wage gains (mainly housing) are taken into account, real urban incomes increased by perhaps 50% by the mid-

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<sup>1</sup> State Statistical Bureau, Statistical Yearbook of China 1986, p. 573. On the other hand, the inflation, especially of food costs which account for close to 60% of urban workers' expenditures, had already begun to erode these gains by the mid-eighties. Thus, according to the government, the index of average real wages increased from 115.2 in 1978 to 154.3 in 1984, but then fell back to 153.1 in 1985. Ibid.

1980s.<sup>2</sup> At the same time, urban workers found more to spend their rising incomes on. The new emphasis on light industrial production, combined with new policies permitting imports of consumer as well as producer goods vastly increased the provision of consumer durables. Finally, the relaxation of prohibitions against individual and small private businesses from barbershops to restaurants to market stalls, greatly enlivened daily life providing badly needed goods and services and jobs for millions of unemployed youth. By any measure, these were tremendous improvements. Like the post-Stalin reforms of Krushchev, Deng's bid to improve the lot of the direct producer came as a welcome relief after decades of ration cards and blue uniforms.

But the visible improvement in living standards, though important, were often taken as an indicator of the partial, if as yet incomplete, success of the market socialist reform strategy as a whole. This, in my view,

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<sup>2</sup> For example: Urban per capita living floor space increased from 4.2 to 6.3 sq. meters from 1978 to 1984. In the same period, the number of bicycles per 100 persons rose from 7.7 to 18.8; the number of TV sets per 100 persons rose from 0.3 to 4.6; the number of books and magazines printed per person per year doubled; the number of university students rose by 51%; the number of doctors increased by 24%. Almanac of China's Economy, Xue Muqiao, ed., (Hong Kong: Modern Cultural Company, Ltd., 1986), p. 57.

was a mistake. It does not diminish the significance of the reforms to point out that it was relatively easy for the reformers to improve living standards by shifting resources from capital goods to consumer goods production. These improvements were only to a very small degree attributable to enlarging the scope of the market. For the most part, they resulted simply from planned changes in priorities with regard to the allocation of investment and consumption funds, and in the allocation of investment funds between producer and consumer goods.<sup>3</sup> It was also relatively easy to discard Mao's preference for self-reliance and open up the economy to greater trade and cultural exchange with the West (indeed Mao himself had led the way in 1972). None of these reforms presented much of a challenge to the system, and most of them had previously been adopted, in the Soviet Union.

Important as these are, they were not the main goals of the reforms. The main goals of the reforms were to "rationalize" industrial management, production and organ-

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<sup>3</sup> From 1978 to 1985, the proportion of national income devoted to accumulation fell from 36.5% to 33.7%, dipping to just over 28% in 1981 and 1982. Between 1978 and 1984 light industry's share of gross industrial output grew from 43.1% to 47.4% State Statistical Bureau, Statistical Yearbook of China 1986, p. 49; and State Statistical Bureau, Xue Muqiao (ed.), Almanac of China's Economy 1985/86 (Hong Kong: Modern Cultural Company, Ltd. 1986), p. 5.



ization in order to overcome the long-standing problems that had plagued the economy since the early 1950s: low productivity, inefficiency, duplication and waste, irrational investment and reward (wage) policies, lack of specialization and coordination, persistent technological stagnation, tendencies toward extensive rather than intensive growth, tendencies toward imbalance with a bias toward heavy industry. With respect to these problems, Deng's market socialist strategy has proven spectacularly unsuccessful. Indeed, as I shall try to show, in many respects the reforms actually worsened the situation by exacerbating existing problems, and adding new problems in the shape of runaway capital spending, ballooning wage bills, revenue shortfalls, state budget crises, mounting foreign debt, and an unprecedented wave of economic crime (jingji fazui). How did this happen, and why?

#### **I. INDUSTRIAL PERFORMANCE: OUTPUT AND PRODUCTIVITY: THE QUANTITATIVE PICTURE**

At first glance, China's industrial performance since the reforms appears very impressive in quantitative terms. Between 1978 and 1986 China's industrial output more than doubled, growing at an average annual rate of 10.2 percent. (Table 3.3). This rapid growth of industrial (as well as agricultural) output generated a number of optimistic projections about China's future economic per-

formance.<sup>4</sup> Harvard economist and China specialist Dwight Perkins, for one, suggests that, so long as the reformers remain in control, "there is every reason to believe" that China will soon join the ranks of the "rapid developers" of East Asia whose take-off into sustained growth (to borrow a phrase from Walt Rostow) has been fueled by regular and system-wide productivity increases.<sup>5</sup> Perkin's specific claim that China's current industrial growth is mainly driven by productivity increases is idiosyncratic, and goes against what is, I think, overwhelming evidence to the contrary, but his general assumption that China is on the verge of making the transition to a market economy has been widely shared.<sup>6</sup> In my view, a closer look will show

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<sup>4</sup> See eg. the World Bank Country Report, China: Long-Term Development Issues and Options.

<sup>5</sup> Perkins, China: Asia's Next Economic Giant?, (Seattle: University of Washington Press, 1986), p. 22-23, 85 and passim.

<sup>6</sup> Perkins argued his thesis of productivity-driven industrial development most forcefully in a recent article in the Journal of Economic Literature (see the bibliography). There is no dispute that recent agricultural growth has been based in part on significant, although limited, increases in productivity, but Perkins maintains that this has also been the case in industry. For evidence and arguments to the contrary, see Gene Tidrick, Productivity Growth and Technological Change in Chinese Industry, World Bank Staff Working Paper No. 761 (World Bank: Washington D.C. 1986); and the several studies by the leading Western authority on Chinese industrial productivity, Robert Michael Field, in particular: "The slow growth of productivity in Chinese industry, 1952-1981" China Quarterly, no. 96 (December, 1983), pp. 641-64; and (with Helen

that there is no basis for the assumption that China's current industrial growth is driven largely by productivity increases, nor is there any basis for the assumption that any large portion of China's industrial economy is currently, or about to be, driven by market forces, as Professor Perkins suggests.

First, with respect to the issue of the industrial growth rate: China's post-reform average industrial growth rate of 10.2% p.a. is indeed very high, but not exceptional by historical standards. It actually falls significantly short of the 13.3% average rate of growth achieved over the long-term 1950-79 and, interestingly, just barely surpasses the quite respectable 9.8% average rate of growth achieved during the decade of the Cultural Revolution (1966-76) when the crazy radicals were in charge.<sup>7</sup> It would appear, therefore, that the reforms must

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Louise Noyes), "Prospects for Chinese industry in 1981," China Quarterly, no. 85 (March 1981), pp. 96-106; and "Changes in Chinese industry since 1978," China Quarterly, no. 100 (December 1984), pp. 743-761.

<sup>7</sup> The figure for the period 1950-79 is from the Almanac of China's Economy 1981, p. 961. Even excluding the years of rapid recovery in the immediate post-war period, industrial output still grew at a rate of 11.1% p.a. between 1953 and 1979. The figure for the years 1966-76 is derived from Robert Michael Field, "The performance of industry during the Cultural Revolution: second thoughts," China Quarterly no. 108, December 1986, p. 627, table 1.

be credited with reviving industrial growth from the lows of the mid-seventies, but they certainly have not led to any great breakthrough in the rate of growth as such.

Turning to the question of productivity growth, it is difficult to find any successes at all for the reforms. For despite the emphasis on economic incentives, bonuses, market pressures and the like, by most measures, industrial productivity not only has not risen, but continued to fall, by some measures rather precipitously. True, in terms of output per worker-year, labor productivity has steadily increased -- as it did over the entire pre-reform period. Between 1978 and 1986 the gross value of output per worker climbed by nearly 39%, or 4.2% per annum -- thus actually exceeding the long-term average growth rate of 3.9% from 1952-1979. (Cf. Tables 3.1 and 1.4 column 5). But once again, as in the pre-reform period, this rising output per worker has only been made possible by increasing factor inputs (especially capital) even faster, so that in reality this index has tended to obscure real falls in factor productivity. When the growth in output value is compared with the growth in the mass and values of inputs (labor and capital), it is evident that the per-unit cost of output has risen substantially since the introduction of reforms. Indeed, it is an irony -- given

the "no nonsense" "down to business" orientation of the reformers, in contrast to their predecessors, that industrial performance since the reforms is actually, in many respects, considerably worse than over most of the pre-reform period.

**Table 3.1: GVIO Per Worker Per Year in  
State-owned Industrial Enterprises**

Year	Labor productivity in state-owned units (Rmb/ person-year at 1980 constant prices)	Change over previous year	Index
1952	4,184		100
1957	6,362		152.1
1965	8,979		214.6
1978	11,130		266.0
1979	11,838	6.4	282.9
1980	12,080	2.0	288.7
1981	11,863	-1.8	283.5
1982	12,113	2.1	290.0
1983	13,049	7.7	311.9
1984	14,070	7.8	336.3
1985	15,198	8.0	363.2
1986	15,451	1.6	n.a.

Total increase 1986 as % of 1978 = 139

Average increase per year (%) = 4.2

Sources: 1952-1982, Zhongguo Tongji Zhaiyao 1983, p. 101.  
1983, Statistical Yearbook of China 1984,  
p. 270.  
1984-85, Statistical Yearbook of China 1986,  
p. 273.  
1986, Statistical Yearbook of China 1986,  
p. 275.

First, looking at Table 3.2. According to official statistics, the gross value of industrial output per 100 yuan of original value of fixed assets dropped from 134 to 103, or 30.1%, in the 26 years between 1952 and 1978. It

fell another 15.7% in just the 8 years from 1978 to 1986. To take another index, whereas profits per 100 yuan gross value of output actually increased by 9.2% between 1952 and 1978, from 1978 to 1986 these profits plummeted by 34.8%. Again, profits and taxes per 100 yuan expenditure of funds, which fell by 4.1% from 1952 to 1978, fell by 23.2% from 1978 to 1986. Or again, the amount of working funds required to yield 100 yuan of output value increased by half a percent. And so on.<sup>8</sup>

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<sup>8</sup> See the complete tables in the sources listed for my Table 3.2 for further indices, all of which reveal the same trends.

Table 3.2: Industrial Productivity Indices (current yuan)

	Output value per Rmb. 100 original value of fixed assets	Profits per Rmb. 100 of gross industrial output value	Profits & taxes per Rmb of funds	Working funds required per Rmb 100 of output value
1952	134	14.2	25.5	23.1
1957	139	17.1	34.8	19.4
1965	98	21.3	29.8	25.5
1978	103	15.5	24.2	32.0
1980	101	15.5	24.8	30.1
1983	95.1	14.1	23.2	28.5
1984	96.1	14.2	24.2	27.2
1985	95	13.0	23.8	28.7
1986	89	11.5	20.7	32.5

Note 1) The data on fixed assets is based on the accumulated total value using the original purchase price. See Field, "Changes in Chinese industry since 1978," p. 744.

Note 2) The term "working funds" (liudong zijin) is somewhat ambiguous, but apparently denotes working capital required in the production process, such as raw materials, fuels, and goods in process, but not labor costs. For definition and discussion of this term see Shigeru Ishikawa, National Income and Capital Formation in Mainland China, (Tokyo, Institute of Asian Economic Affairs, 1965), pp. 105-6; and Carl Riskin, China's Political Economy, p. 283, note 3.

Sources: 1952-1984, Zhongguo Jingji Nianjian 1985/86 (English edition), p. 29  
1984-1986, Zhongguo Jingji Nianjian 1987, p. III-30

Further evidence of declining productivity and efficiency is apparent in other measures, particularly those which take into account the relatively growing mass of labor inputs, the increasing per unit cost of labor, and the rising rate of current (as contrasted with cumula-



tive total) investments in fixed assets. Looking at the data in Table 3.3 it can be seen that the 113% increase in the value of industrial output (GVIO) between 1978 and 1986 required a 35% increase in the labor force, a 339% increase in the total wage bill, and a 296% increase in investments in fixed assets. In terms of growth rates per year, to maintain a 10% average annual increase in the GVIO required corresponding average annual increases of 4.5% in the labor force, 21.4% in the wage bill, and 15.6% in fixed investments. In other words, the productivity of labor in terms of output per yuan of wages fell by 37% in just eight years. In the same period the productivity of fixed capital (output per yuan of current investment) fell by 38%. The tremendous relative increase in the cost of labor is explained two factors: first, in the late 1970s the reformers sought to employ many of the millions of unemployed youth, many of whom had been "sent down" to the country during the Cultural Revolution and were drifting back to the cities, by adding them to (often already overstaffed) factories. Secondly, as noted above, the reformers also increased wages by roughly fifty percent (whereas, by comparison, wages had remained nearly constant between 1957 and 1978, as noted in chapter one). Together, these reforms had the effect of increasing the mass of labor embodied per unit of output (i.e. increasing the labor intensification of production), and also raising

the unit cost of this labor -- both to the detriment of efficiency. The reasons for the huge relative increase in investments in fixed assets will be explored in Part II below, but the declining efficiency of this growing investment is apparent in the increasing capital/output ratio (Table 3.3 column 2 vs. column 5), and in the rising capital/labor ratio (Table 3.3 column 3 vs. column 5).

**Table 3.3: Growth in Industrial Output in Relation to Growth of the Labor Force and Fixed Assets**

Year	GVIO (100 million yuan)	Average number of workers & staff in state-owned & urban collective units (10,000)	Wage bill of workers and staff in state- owned units (100 million yuan)	Growth of Investments in fixed assets in state-owned units (100 million yuan)
1978	4,231	9,499	468.6	668.72
1979	4,591	9,967	529.4	669.36
1980	4,992	10,444	627.9	745.90
1981	5,178	10,940	660.4	667.51
1982	5,577	11,281	708.9	845.31
1983	6,164	11,515	748.1	951.96
1984	7,030	11,890	875.8	1,185.81
1985	8,295	12,358	1,064.8	1,680.51
1986	9,028	12,809	1,587.6	1,987.50
Total Increase (percent)				
1978-86:				
	113.4	34.9	338.8	295.9
Average yearly rate of growth (percent per year)				
1978-1986:				
	10.0	4.5	21.4	15.6

Note 1) This table substantially underestimates the growth of the "industrial" workforce to the extent that it excludes the following categories: (a) "collective and individual laborers in rural areas" which have grown from 303.4 million in 1978 to 370.1 million in 1985, many of whom are increasingly village industries at least part-time, and whose output (11% of industrial output in 1985) since 1985 has been counted under industrial instead of agricultural headings; and (b) "individual laborers in cities and towns" who have grown from around 150,000 in 1978 to some 4.5 million in 1985, many of whom are involved retail trade and service industries but some of whom are small producers or handicraftsmen whose output is also counted as industrial output. See Statistical Year-book of China 1986, p. 31, note 2.

Note 2) GVIO for 1978-80 at 1970 constant prices, 1981-86 at 1980 constant prices

Sources: GVIO: Statistical Yearbook of China 1986, p. 225.  
Statistical Yearbook of China 1987, p. 220.  
 Workers & Staff: Statistical Yearbook of China 1986, p. 92.  
 Wage bill: 1978, 1980, Almanac of China's Economy 1985/86, p. 12.  
 1979, 1982, Statistical Yearbook of China 1984, p. 455;  
 1981, Zhongguo Tongji Zhaiyao 1983, p. 159.  
 1978 and 1979 figures are at 1970 constant prices, figures for 1980-85 are in 1980 constant prices.  
 1984, 1985, Statistical Yearbook of China 1986, p. 559.  
 1986, Statistical Yearbook of China, p. 596  
 Fixed assets: 1978-83, State Statistical Yearbook 1984, p. 301  
 1984-85, State Statistical Yearbook 1986, p. 365.  
 1986, Statistical Yearbook 1987, p. 401.

While the broad implications of these tables are quite negative for the reform project, for much of Chinese industry the true picture may actually be worse than these statistics indicate. In the broadest and most systematic empirical investigation of Chinese industry undertaken to date, the China Economic System Reform Research Institute (hereafter CESRRI) under the State Council, studied 429 enterprises in 27 cities and concluded, inter alia, that when the costs of subsidies and redundant employment are factored in, "the true cost of each urban worker more than

doubled in the period 1979-1984, while national income generated by them during the same period increased by 9.28 percent."<sup>9</sup> In sum, whatever the precise numbers may be, these trends clearly indicate that with respect to the reformers' main strategic goal of shifting to more intensive methods of growth, i.e. increasing factor productivity, the reforms have been, to put it bluntly, an unmitigated failure. The reforms raised wages and altered the composition of production, increasing the output of consumer goods, but they have not been able to raise the productivity of labor or the efficiency with which capital is used.<sup>10</sup>

Given steady declines in labor and capital productivity the question naturally arises, how has the post-reform leadership nevertheless managed to sustain such a high rate of industrial growth? The answer appears to be that it has done so by the same methods as in the past, by means of extensive growth -- adding ever more workers and equipping them with ever more plant and machinery.

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<sup>9</sup> Reform in China: Challenges & Choices, Bruce L. Reynolds, ed., (Armonk, New York, 1987), p. 95 and pp. 9-11. Hereafter, I will cite this important work as CESRRI Survey.

<sup>10</sup> Cf. Field, "Changes in Chinese industry since 1978," p. 750. Also, Carl Riskin, China's Political Economy, (Oxford: Oxford University Press, 1987), pp. 371-72.

As we saw, between 1978 and 1986 the urban industrial workforce grew by 34.9%. or by an average of 4.5% per year (and as noted in Table 3.3, this figure substantially underestimates the true growth of the industrial workforce since village industrial output is now counted under industrial instead of agricultural output but village industrial workers are not counted under the urban industrial workforce). This means that close to half (and probably more) of the 10% average annual increase in industrial output has been accounted for by a simple numerical increase in the industrial workforce. The remaining (5.5%) increase in the growth of output and productivity can be attributed to changes in other inputs -- worker skills, management effectiveness, more efficient use of plant and equipment, and upgrading and addition of new plant and equipment. Of these, we lack the data to measure changes in worker skills and management effectiveness. But undoubtedly the most important factor determining increases in output is the amount of physical capital available per worker.<sup>11</sup> By this index, gains in output and productivity (output per worker) have been very costly. As

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<sup>11</sup> For discussion of this point see Riskin, China's Political Economy, p. 265. See also Robert Michael Field, "The slow growth of productivity in Chinese industry, 1952-81, China Quarterly no. 96 (December 1983), p. 651.

we saw, between 1978 and 1986, investment in fixed assets grew by an annual average of 15.6% (Table 3.3) -- this to yield increases in output averaging only 6.5%. Increased investments have taken two forms: an increase in the number of factories and plants, and an increase in the amount of equipment per worker, usually via upgrading or renovation of existing facilities. In 1978 Chinese statisticians listed 348.4 thousand industrial enterprises.<sup>12</sup> By 1986 the number of enterprises had grown by 43.3% to 499.3 thousand. In short, the reformers have maintained a 10% average annual rate of industrial growth by increasing the industrial workforce by more than 35% and by increasing the number of production units (factories and plants) by more than 43%. Finally, in the absence of significant productivity increases, such a capital intensive strategy of development has only been made possible by maintaining a high rate of accumulation -- and increasingly, by borrowing abroad (see below). Between 1978 and 1985, the state reinvested an annual average of 32% of the national income

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<sup>12</sup> State Statistical Bureau, Statistical yearbook of China 1986, p. 189. Of these 1.3% were classified as large and medium sized enterprises, 24% were classed as state-owned and 76% as collectively-owned.

back into production.<sup>13</sup> By international standards, China's rate of accumulation and investment has consistently been one of the world's highest. Converting Chinese data to the Western national accounting framework (Table 3.4), it can be seen that China's rate of savings and investment is higher than all the industrialized capitalist countries, including Japan and South Korea. It has been equaled or exceeded only by Yugoslavia (and Singapore) among countries reporting to the World Bank.<sup>14</sup> In retrospect, with more than a third of national income plowed back into accumulation (investment) each year, the wonder is perhaps not that China's industrial output has grown at 10% per annum, but that it hasn't grown faster.

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<sup>13</sup> State Statistical Bureau, Statistical Yearbook of China 1986., p. 49. See also, World Bank, China: Long-Term Development Issues and Options, chapter 9.

<sup>14</sup> This statement excludes the USSR, the remaining East European and other Soviet bloc countries, and North Korea, which are nonreporting nonmembers of the World Bank.



**Table 3.4: Saving and Investment: International Comparisons**

Country:	China				United States	Japan	South Korea	India	Yugoslavia
	1952	1957	1979	1986	1986	1986	1986	1986	1986
Gross domestic investment (% of GDP)	21	23	31	39	18	28	29	23	38
Gross domestic savings (% of GDP)	n.a.	n.a.	n.a.	36	15	32	35	21	40

Sources: China 1952-1979, World Bank, China: Socialist Economic Development, 3 vols., (Washington D.C.: World Bank, 1983), vol. 1, p. 79, table 3.10. The figure for China 1952 (only) is expressed as a percentage of "total material expenditure" rather than Gross Domestic Product as data for the latter are not available for 1952. All other data are from World Bank, World Bank Development Report 1988, (New York: Oxford University Press, 1988), pp. 230-1.

To sum up, in quantitative terms, China's reform leadership has managed to sustain a high rate of industrial growth since 1978, but essentially by the same methods as in the past -- by pouring in ever increasing amounts of resources: adding more workers, more plant and equipment, but without significantly improving the efficiency with which these resources are used. The

implications of this go beyond the industrial sphere. Most obviously, declining efficiency has meant declining industrial profits paid to the state. This has meant that the government has been able to keep incomes up only by increasing (instead of decreasing) subsidies. By the mid-1980's direct subsidies to consumers amounted to almost half of central government expenditures, and over 20% of total government expenditures.<sup>15</sup> Declining revenues has furthermore meant that the government has been forced to pay for this fast but inefficient growth strategy by borrowing from the international money markets.<sup>16</sup> Whereas up to 1979 China had accumulated virtually no foreign debt, in the early 1980's China turned increasingly to Western

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<sup>15</sup> These figures are derived from the tables on page 525 of the Statistical Yearbook of China 1986.

<sup>16</sup> In the effort to balance its books, since 1981 the government has also resumed the practice of issuing bonds. In 1981 the government sold nearly 5 billion yuan to state and collectively-owned units, almost all on an involuntary basis. If these are not paid back (which is likely) they become a disguised form of taxation (and hence not debt). About half the 4 billion yuan of bonds issued in 1982 and 1983 were sold to individuals, presumably voluntarily, as these carried an eight percent annual interest rate, higher than rates offered by the State banks. Also, presumably these will be repaid, so this category constitutes a small but growing domestic debt. See Dean Carver, "China's experiment with fiscal and monetary policy," in J.E.C. China's Economy Toward The Year 2000, 2 vols. (Washington D.C.: U.S. Government Printing Office, 1986), vol. 1, p. 122.

bankers (mainly Japanese) to compensate for the inability of its backward and inefficient industrial sector to earn sufficient foreign exchange through exports, to fuel economic development. The foreign debt grew rapidly. In the space of just three years from 1983-86 China's international debt tripled to nearly 27 billion dollars (far less than the cumulative debts of Brazil or Mexico, but exceeding those of Poland and Yugoslavia) -- prompting the IMF in March 1987 to warn the Chinese government that its "external debts are no longer light, its debt structure is irrational and that its debt management is not well coordinated."<sup>17</sup> However, by mid-1988 China's debt had grown to 30 billion dollars, and by the spring of 1989 its foreign debt surpassed 40 billion dollars.<sup>18</sup>

## II. QUALITATIVE PROBLEMS, OLD AND NEW

The disappointing performance of China's industrial economy in quantitative terms is only an expression of the failure of the reforms to overcome the whole range of qualitative problems that have long impeded China's indus-

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<sup>17</sup> See Louise do Rosario, "In the big league," Far Eastern Economic Review, March 26, 1987, p. 53.

<sup>18</sup> China Daily, July 25, 1988; Beijing Review April 3-9, 1989, pp. 23-25.

trial development, and to resolve new problems that have cropped up as a result of the reforms themselves. In the heyday of reform in 1978-79, China's reformers and their Western promoters maintained that in theory, financial and managerial decentralization, would result in more "rational" -- by which they meant more market oriented patterns of output, wages and investment. In the reformers vision, devolving substantial authority onto industry's managers, permitting them to retain a portion of their profits for reinvestment and for employee incentives, holding them responsible for profits and losses, and pitting them in competition with one another, would turn them into profit-maximizing, cost-cutting, efficient and innovative "socialist entrepreneurs." Economic competition (which was assumed would emerge with the phase-out of state planning and purchase and the emergence of competitive bidding for state contracts) would compel management to act in a more economically rational manner, to pay attention to "economic laws," particularly "the law of value." Market pressures would force labor to perform, and force management to specialize, invest rationally, cut costs and innovate to boost efficiency. At the same time, management's newly won discretionary authority would enable it to reward the efficient and penalize the lazy, and to gear production and investment more closely to market signals. All would have to perform to survive the

"natural selection" of the new competitive environment. In the words of a People's Daily editorial of the time:<sup>19</sup>

Competition forces leaders of an enterprise to strive to make the enterprise grow, to improve management, to raise the quality of products, to reduce production costs and to put cheap but good products on the market. This forms a sharp contrast with the past situation in which 'products were turned out as usual whether or not they found a market,' 'wages were paid as usual whether or not the enterprise made a profit or incurred a loss' and people 'shared food from the same big pot' under socialism.

As it turned out, although there have been some undoubted gains, notably in the output of consumer goods, for the most part, the reforms produced results which were totally unexpected and in most respects the the opposite of the intentions of their advocates. For, in contrast to the reformers expectations, industrial managers and local authorities have regularly and systematically pursued highly irrational strategies that controverted the goals of the reformers. They did not use their newly won powers to rationalize production, to specialize, to cut costs and waste, to innovate and boost efficiency or gear production more closely to the market, but, by and large, instead to

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<sup>19</sup> Renmin Ribao, June 6, 1980, JPRS no. 76006, July 8, 1980 p. 4. See also the "Provisional Regulations Concerning the Development and Protection of Socialist Competition" adopted by the State Council, October 17, 1980, in op. cit., pp. 220-222, and the numerous similar statements to the same effect by the reform economists and politicians in 1978-80, especially Xue Muqiao, Zhao Ziyang, et al.

maximize growth regardless of cost or profitability, to inflate the wage bill, to reinforce self-sufficiency and hoard resources and to siphon off surpluses from the state by a variety of legal and illegal means.

II.A. The Impact of Reform on Investment Strategies:  
Profit Maximization vs. Income Maximization

For example, marketization was supposed to pressure factory managers to i.e. to cut costs, especially to shed unnecessary labor, redundant facilities, excess stocks, and to plow funds back into revolutionizing the means of production to boost efficiency, and into boosting output where opportunities presented themselves. Correlatively, decentralization was supposed to give them the capacity to carry out these tasks. Decentralization transferred control of vast resources to lower levels. Whereas in 1978 more than 80% of capital construction investment was directly managed by the central ministries, since 1982 control over about 50% of the total investment budget has been assumed by local authorities (Table 3.5). This was, more or less, to be expected. What was not anticipated, however, was the increasingly irrational character of this growing out-of-plan investment by lower level officials.

**Table 3.5: Capital Construction Investments by  
State-owned Units -- Source of Investment**

Year	Investment Construction (Rmb. 100 million)			Proportion (Total = 100%)	
	Total	From State Budget	Self-financed by Departments, Localities and Enterprises	From State Budget	Outside State Budget
1978	500.9	417.4	83.6	83.3	16.7
1979	523.5	418.6	104.9	80	20
1980	558.9	349.3	209.6	62.5	37.5
1981	442.9	251.6	191.4	56.8	43.2
1982	555.5	276.7	278.8	49.8	50.2
1983	594.1	345.8	243.4	58.2	41.8
1984	743.2	404	339.2	54.4	45.6

Source: State Statistical Bureau, Almanac of China's Economy 1985/86, p. 68.

### 1. Growth at Any Cost

The "foreign imports craze" of 1977-78 was perhaps the most dramatic example of this pattern of irrational spending, and in particular, the bias toward growth at any cost. Freed from central control, officials from hundreds of enterprises, departments, and localities went on a vast spending spree squandering their retained profits on the import of foreign means of production, often complete plants for the chemical, iron and steel, coal, petroleum and electric power industries. By one estimate, Chinese firms signed contracts or letters of intent to purchase

some U.S. \$600 billion worth of foreign imports, a rather extraordinary excess considering that China's foreign exchange earnings from exports were running at around U.S. \$10 billion per year.<sup>20</sup> While much very useful technology was imported, much of the equipment was very expensive and often inappropriate for the needs of Chinese industry. For all their schooling in "scientific management," these officials demonstrated an astounding capacity to spend on imports without heed for the scale and cost, and without regard for the lack of raw materials to supply the plants, power to run them, or the lack of auxilliary facilities necessary to make the plants operable. The result was waste on a stupendous scale.

Officials from the Nanjing chemical plant, for example, imported expensive equipment for the manufacture of ethylene, but this had to lay idle because no regular supply of crude oil for raw material could be found to supply the plant.<sup>21</sup> In Xinjiang, officials spent more than Y100 million importing equipment to build an iron and steel plant at Hejing "that was found to be useless"

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<sup>20</sup> Dwight Heald Perkins, "Reforming China's economic system," p. 614.

<sup>21</sup> Xinhua, September 3, 1980; FBIS September 4, 1980, p. L18.



according to the press, and another Y200 to build an oil refinery at Urumqi, "that was not put into operation."<sup>22</sup> Even more costly in terms of losses, officials in charge of the Wuhan Iron and Steel Company in Hebei province, spent several billion yuan importing a 1.7 meter steel rolling-mill. To update their plant they imported the very latest, and most expensive technology from West Germany including a foundry, a steel plate hot-rolling mill, a steel plate cold-rolling mill and a silicon steel strip plant. Designed capacity was 3 million tons of thin steel plate a year. Not until it went into operation, however, according to the People's Daily, was it discovered that first, there was not enough electricity in all of Hebei province to run the plant, and so it could run only at half capacity at most; secondly, there were no raw materials available for silicon steel, so the rolling mill had to be refurbished additional cost to produce less sophisticated enameled pressed steel; thirdly, despite its advanced equipment, its low productivity put production costs so high that the mill's products were noncompetitive in the international market. As a result, the paper explained, "The original plan of using foreign exchange to import the equipment first and earn foreign exchange later

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<sup>22</sup> Ibid.

by selling the mill's products cannot be realized for the time being."<sup>23</sup>

But no doubt the most spectacular of these fisacos was the giant \$14 billion Baoshan Steel project, situated on the Yangtze estuary north of Shanghai. A consortium of foreign steelmakers under Japanese leadership began the project in 1978. Baoshan was the pride of Deng's technocrats, China's single most ambitious industrial undertaking since the revolution, and it was intended as a showcase of East-West cooperation. But as it turned out, the Shanghai region lacked sufficient electrical power to run such a complex. Moreover, the blast furnaces ordered by the officials in charge proved too sophisticated for China's low-grade ore, so ore had to be imported from Australia. Worse still, it seemed that the site chosen could hardly have been less appropriate. Virtually inaccessible by rail, it proved unreachable by sea as well, because deep-draft ore carriers could not navigate far enough up the heavily silted river. Even more amazing, it was reported that because of inadequate preliminary soil studies, thousands of the steel piles driven into the marshy land of the site to underpin the plant sank out of

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<sup>23</sup> Renmin Ribao, August 1, 1980, p. 2, FBIS August 15, 1980 pp. L11-12.

reach.<sup>24</sup> In the face of staggering losses, the government was forced, in February 1981, to halt work on the ill-conceived project and cancel contracts for its completion.<sup>25</sup> The Baoshan project was of course extraordinary in scope, but it typified the growing pattern of irrational investment throughout the economy.

### **"Blind Expansion"**

Handing control over economic decisionmaking and investments down to the enterprises and localities was supposed to gear production more closely to actual needs, thereby reducing waste and misallocation of resources. But as the reforms took effect, the leadership increasingly complained that local officials and enterprise directors, awash in investment funds, were plowing investments into "blind production" (mangmu shengchan) and "blind expansion" of their own units of production regardless of the "needs of the market" or the goals of the central planners. Production boomed, and so did capital spending. But,

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<sup>24</sup> See Dori Jones, "The Baoshan contracts," The China Business Review, July-August 1980, pp. 47-9; Martin Weil, "The collapse of construction projects," The China Business Review, January-February 1981, pp. 9-13; and Far Eastern Economic Review, February 20, 1981.

<sup>25</sup> New York Times, April 9, 1981; The China Business Review, January-February 1981, pp. 9-13. Work was subsequently resumed on the project but by the end of 1985 it was still not in full operation.

for the most part, this increased investment did not go into technical renovation, productivity improvements, or into badly needed sectors such as transportation, communications, energy and heavy industry -- but into greater output of goods, especially light industrial and consumer goods which were already, or soon became overstocked, and into the construction of small-scale and often inefficient plant.

Thus, although the steel and the machine tool industries had already accumulated vast overstocks by 1978, during 1979 according to government reports, overstocks of rolled steel grew by another 22% over the previous year, and overstocks of machinery and power equipment increased by a further 11.7%.<sup>26</sup> The same trend continued in 1980.<sup>27</sup> Worse, as Ma Hong, one of China's leading economists, noted: "Although gross output

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<sup>26</sup> State Statistical Bureau, "Communique on the Fulfillment of the 1979 Economic Plan," Xinhua, FBIS April 30, 1980, p. 2. In Beijing alone, with an annual turnover of 700,000 tons of steel for the whole city, accumulated overstocks reached 460,000 tons in the first quarter of 1979, creating a backlog of more than seven months. Yet, Beijing Ribao reported in June 1979, that the "city's steel product and industrial raw material stocks have not dropped since this year; on the contrary they have increased. . . steel product stocks have risen by 30%, . . . coal and coke stocks increased by 40% and that of pig iron by 70%." June 3, 1979, FBIS June 19, 1979, p. R3.

<sup>27</sup> See the text of the "Communique" for 1980.

increased, there was very little increase in the amount of useful steel products turned out; there was neither a significant rise in the number of varieties nor a great improvement of quality standards. Consequently, total excess steel supplies were even greater than in the past."<sup>28</sup> Although the machine-building industry had already reached a stage of "serious overcapacity," with the rate of utilization of machine tools reaching barely 52% in 1979, another 2018 new machinery making enterprises were added in the first ten months of 1980.<sup>29</sup> In China's textile industry, production capacity in 1978 was "already well above levels required by supply levels of domestic raw materials. Yet, factory directors added another 1.02 million spindles in 1979, bringing the total to 16.63 million spindles. In 1980, there was a further increase of 800,000 spindles . . ."<sup>30</sup> The same story could be told for many other key industrial lines.

In the provinces, decentralization sparked an unprecedented investment boom. In agricultural regions,

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<sup>28</sup> New Strategy for China's Economy, pp. 76-7.

<sup>29</sup> See the report of Wang Haibo and Wu Jiajun, "China's Industry in 1980," published in the Almanac of China's Economy 1981, p. 452.

<sup>30</sup> Ibid., p. 452.

local officials rushed to set up small processing industries to turn cotton into textiles, tobacco into cigarettes and raw silk into yarn, to process tea and sugar, to make wine, etc. Everywhere local officials set up light industrial plants to manufacture domestic appliances, plastics, clothes, and building materials. One problem, however, was that many of these small-scale plants were drawing supplies of raw material and energy away from larger and/or more efficient plants in the cities. The government complained that, on the excuse of emphasizing their "comparative advantage" and "responding to the call to boost output of light industrial goods,"<sup>31</sup>

areas producing raw materials for the light and chemical industries have blindly built small cigarette plants, small distilleries, small paper plants, small silk reeling mills, small soap plants, small dyestuff plants and small paint plants. While old and large plants cannot operate to their full capacity because of shortage of raw materials, new

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<sup>31</sup> Hongqi, June 1, 1981, pp. 42-43, FBIS July 2, 1981, p. K10. The article further noted that "at present there is excess capacity in the existing textile industry throughout the country, and the production quotas are not sufficient to keep some large plants operating at full capacity. Nevertheless, a lot of cotton producing regions, communes and brigades are still looking for old fashioned textile equipment that has been disposed of by old plants and are constructing a great number of medium and small cotton mills with them. For this reason, they even unilaterally cut off the established cooperative relationship with other textile enterprises, retain cotton which should be exported to the latter according to the plan, or just supply them with materials of inferior quality and keep the superior stuff for themselves" (emphasis added).

and small plants are being promoted which compete with the former for raw materials. With old equipment and backward technology, they turn out inferior products at the expense of high consumption of raw materials. Moreover, some of them even seriously pollute the environment. Despite the national unified planning for exploiting mines, some local enterprises have excavated around or even within the boundaries of large existing mines run by the state. This had not only affected the regular production of the existing mines, but also destroyed and caused great waste of natural resources.

"In some provinces, municipalities and autonomous regions," the press reported in March 1979, "projects under construction do not merely number in the hundreds, but in the thousands."<sup>32</sup> In December 1980, a Renmin Ribao editorial complained that since the implementation of the reforms, local officials were still investing systematically in their own projects regardless of the economic irrationality of such enterprises:<sup>33</sup>

While some plants are not running at full capacity owing to the shortage of raw and other materials and energy, similar plants are running at partial capacity, many localities are rush-building medium-sized and small plants of the same type. Some localities are forcing themselves to build projects when they clearly understand the technology they have is poor, that the equipment available is backward and that as soon as these projects start production, deficits will appear. . . . It should be pointed out that the erroneous practice of small plants competing with large plants, plants using advanced technology competing with those using outdated technology and new

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<sup>32</sup> Xinhua, March 22, 1979, FBIS March 27, 1979, p. L8.

<sup>33</sup> December 2, 1980, FBIS December 3, 1980, pp. L7-8.

plants competing with existing plants is increasing rather than disappearing (emphasis added).

A conference of the People's Construction Bank in October-November 1980 condemned the growth of "overlapping projects as machinery plants, foundry plants, machinery maintenance plants, motor vehicle repair plants, shipyard and electronic computer plants built by various departments in their localities." Officials noted that "the machine-building industry is starving for production work, but quite a number of places are still blindly building machinery repair shops, foundries and machine-building plants." "One province already had a rather well-equipped silk mill, whose production capacity was already greater than the quantity of silkworm cocoons the entire province could supply. But 13 new silk reeling mills have been built in the past few years. The result: two-thirds of the silk reeling equipment in the province is lying idle." "One autonomous region used to have large quantities of hides for transfer to other places. Now, because communes and production brigades are vigorously setting up small tanneries, the region not only fails to fulfill targets for hide transfer to other places, but can't even guarantee the raw materials required by its own large tanneries." "Moreover, the number of electronic computer centers and film studios built in various places is also quite large. In one medium-size city, 15 organizations



have installed a total of 20 electronic computers. The utilization rate of some of these computers is less than five percent, but five more organizations still want to build electronic computer centers."<sup>34</sup>

## 2. Prices, Profitability, and "Light Industrialization"

To a very great degree, the pattern of this investment/output expansion has been shaped by the relative profitability of different lines of production. As is well known, in the context of a system in which all prices are set more or less rigidly by the state, the profitability of any given line of production, and even a particular firm within a given line, will vary not only according to the difference between input costs and product prices calculated on the basis of national prices, but also according to a host of conditions specific to individual firms -- location, age, technical level and quality of equipment, ease of transport, availability of raw materials and labor -- any of which may significantly add to or diminish production costs for an individual factory. Moreover, most or all of these conditions are beyond the control of individual plant directors and even ministerial heads. Now in

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<sup>34</sup> Xinhua November 20, 1980, FBIS November 25, 1980, pp. L26-7.

China, as in the Soviet Union and East Europe, the price structure is such that basic consumer necessities such as most food, housing, as well as many producer goods such as some raw materials and energy, are priced below world market rates, and in some instances, below their cost of production. On the other hand, prices of most other consumer goods, especially consumer durables and modest luxuries, are set comparatively high, often higher than world market rates. Obviously, under such conditions (which again are largely beyond the control of producers), reproduction can go forward only under two conditions: first, that the state, through its purchasing agents or by other means, guarantees to buy up virtually all the output of every state firm, and secondly, that the state regularly provides subsidies to those industries or firms that fail to make a profit. And in fact, for reasons which will be explained later, these guarantees have continued to be met, even since the introduction of market reforms. Given these conditions, i.e. unequal production costs combined with guaranteed sales and subsidies, it will be evident that profit rates are virtually assigned by the cost/price ratio of a given line of production and as modified by the specific circumstances of individual firms.

### **The Market vs. the Plan**

This then, was the operational context in which the reform leadership turned the industrial managers loose with the injunction to "maximize profits!" This they did -- but their efforts did not lead, as expected, to a more rational but to an equally irrational, if differently distorted structure of production. (The wonder is that anyone thought decentralization could have produced anything else!) Whereas before 1978, centrally planned industrial output had been excessively biased in favor of heavy industry -- since 1979, decentrally planned investment resulted massive overproduction, overinvestment, and duplication especially in light industrial production. Managers and local authorities sought to maximize profits, and naturally sought to do so whenever they could by investing in the most profitable lines of investment -- logically: all the high profit light industrial consumer and luxury goods described just above. By and large, producers were not free to change product lines. But those who were already in these high-profit lines, and those who could add subsidiary high-profit lines to their existing product mix, sought to maximize production of these products even to the point of overproduction (as we saw), again, because sales (and thus profits) were virtually assured. And given this assurance, these producers also (logically) demonstrated a marked (although not exclusive)

preference for investments which offered quick returns -- again, light industry: bicycles, watches, radios, fans, etc. as against heavy industry which, even if profits were guaranteed, could be realized only in the long run. In the beginning, the expansion of light industrial output output corresponded with the requirements of the reformers, whose strategy of boosting productivity by relying on material incentives required more consumer goods for the workers to spend their increased earnings on. But it was not long before the reform leadership began to complain that the emphasis on light industrialization was "endangering long-term development" because it was draining investment resources away from the heavy industries, such as energy, raw materials, and chemicals (traditionally low profit sectors).<sup>35</sup>

#### **From Decentralization to Particularism**

Crucially, from the perspective of the reformers at the center, the particularism of managers and local offi-

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<sup>35</sup> Reynolds, Reform in China, p. 10. The authors of the CESRRI survey noted that "the net increments of productive capacity in the railroad, highway steel-making, electricity generation, and other sectors in the Sixth Five-Year Plan period have all declined. The development of the raw materials industry is falling even farther behind the needs of economic development. . . The insufficiency of investment in the metalurgical industry will undoubtedly hinder the effort to reverse the increasing dependency on imports for the development of our domestic industry." p. 17.

cials rapidly undermined the central government's ability to enforce its plan (the planned aspect of market socialism), in particular, to guarantee sufficient resources for its own key projects. In June 1983, Zhao Ziyang told the Sixth National People's Congress that "The problem is that state budgetary investment in key construction fields of energy and transportation has failed to reach the amount planned, while capital construction by localities, departments, and enterprises using their own funds or different kinds of loans is out of control and construction or ordinary processing industries and non-productive enterprises far exceeds the plan."<sup>36</sup> In July of the same year, Song Ping, Minister in charge of the State Planning Commission, complained that:<sup>37</sup>

In recent years, the Party Central Committee and the State Council have issued repeated injunctions on strictly controlling the scale of capital construction and paying attention to investment returns, but without success. The principle reason for this has been the overexpansion of self-raised investment funds and those obtained through bank loans. As a result, not only was there no improvement in investment returns, but they actually dropped. . . This has made it impossible to make good use of investment funds, and what happened was that planned projects were replaced by unplanned ones, and key projects by ordinary ones.

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<sup>36</sup> "Report on the work of government," June 6, 1983.

<sup>37</sup> Xinhua, July 12, 1983, FBIS July 13, 1983, p. K10.

Decentralization not only deprived the central government of capital but "created a situation in which building materials are mainly supplied to non-essential projects instead of key construction projects thus holding them up for lack of materials."<sup>38</sup>

**From Decentralization to  
"Miniaturization" of Investment**

Yet ironically, even if industrial managers and local authorities wished to invest in larger scale projects, such projects are beyond their capacity. For, key to the reform strategy was the goal of progressively relinquishing central control over investments, or as the western bankers put it, "getting the government out of the economy." But, in yet another of the many consequences that market socialists failed to foresee, devolving control of investments onto the enterprises and localities resulted in the fragmentation of investment funds, and shortly, to a sharp reduction in the overall scale of investments and new construction. In the words of authors of the CESRRI survey cited earlier, "scattered distribution of investment funds inevitably leads to their scattered utiliza-

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<sup>38</sup> Jingji Ribao, June 30, 1983, pp. 1&4, FBIS July 13, 1983, p. K10. To make matters worse, often the response of local officials to the pleas of the center was "The state has its key projects and I have mine. I collect the funds; this is nothing to do with you." Hongqi, no. 8, April 1983, pp. 16-18, FBIS May 19, 1983, p. K9.

tion. . . The reality we are facing today . . . is the expansion of gross investment coupled with a decline in the scale of investment."<sup>39</sup> In describing the "miniaturization" of plants build since the introduction of reforms, which they liken to "a nationwide blooming of 'stunted trees,' " the authors point out for example that:<sup>40</sup>

The minimal optimal production scale of a washing-machine factory should be 200,000 units per annum. In 1984, of 130 washing-machine factories in the whole country, on 9 reached such a capacity. Of 110 refrigerator factories nationwide, average output was 4,600 units per annum, which is far below national scale. There are over 110 motor factories in China, distributed all accross the country . . . Their average scale is 2,000 cars per annum. Only a few state-financed automobile works established in former years operate up to the requirements of scale economy.

If the government had "gotten out of the economy" by denationalization, i.e. selling off its factories, then competition would permit the larger and more efficient

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<sup>39</sup> Reynolds, Reform in China, pp. 15-16. Also p. 135.

<sup>40</sup> Ibid., p. 16. In a passage which calls to mind aspects of the Great Leap Forward, local officials in Shanxi recently built more than a thousand tiny "one-kick" blast furnaces -- so-called because they could be toppled with one kick! Since such projects "hardly have potential for future renovation and development," the CESRRI researchers conclude that "their existence shows that the efficiency of investment quality has dropped very seriously as the aggregate investment in China continues to expand." Ibid., p. 120.

firms to drive out or take over the inefficient, thus again rendering possible economies of scale -- this time on a capitalist basis. But of course the reformers strategy was premised on the maintenance of state ownership of the means of production. In this context, decentralization offered, in the words of the CESSRI researchers, "no mechanism through which enterprise-retained profits can be pooled and directed horizontally to larger-scale projects -- despite the fact that enterprise-retained profits represent 80 percent of extrabudgetary funds."<sup>41</sup>

Faced with a capital shortage, enterprises and localities were thrown into competition with one another for access to locally-retained profits and bank loans. Some localities, Renmin ribao editorialized, have taken advantage of loosened controls to "fleece the state." "Many people attached more importance to the construction of those projects from which their own districts or departments can directly benefit, or have tried to add them to the list of key projects." Some "evaded taxes, and intercepted profits which should have been turned over to the state. Some enterprises did everything possible to make false reports on basic profits in order to pay less

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<sup>41</sup> Ibid., p. 122.



profit tax to the state."<sup>42</sup> And Xinhua commented that "Regretably at the present time, many units engaged in key projects do not understand the need for frugality, but are wasting money astonishingly. . . Some localities and units . . . take their work as a bait to reap a profit. They manage, in a disguised manner, to raise the construction costs, so as to ask for more funds and materials from the state. Using the extra funds and materials, they build their own small world. . . [constructing] their own processing enterprises and super-standard welfare facilities. . . It is under such circumstances that some key construction projects have become 'bottomless pits,' into which hundreds of thousands, millions, even hundreds of millions of yuan have been poured."<sup>43</sup>

#### II.B. The Growth of Consumption at the Expense of Accumulation

Although the overall level of investment has grown enormously since the introduction of reforms, the share of investment devoted to accumulation has not grown nearly so fast as the share devoted to consumption. In fact, while striving to maximize growth and income, factory directors

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<sup>42</sup> July 8, 1983, p. 1, FBIS August 16, 1983, pp. K3,5.

<sup>43</sup> June 30, 1983, FBIS July 1, 1983, p. K11.

and their local supervisory organizations have sought wherever possible to channel their self-retained funds out of production and into consumption. Perhaps the most important result decentralization has been a sharp relative decline in productive investments (in Chinese usage, investments in means of production, or Department I) of all sorts and, correspondingly, a tremendous increase in the proportion of investments going for non-productive purposes (i.e. investments in means of consumption, or Department II), especially housing. In the four years between 1978-82 the share of total investment in capital construction devoted to non-productive purposes rose from less than 21% to over 45%. Of this, the proportion spent just on residential buildings increased from 7.8% in 1978 to over 25% in 1982. (Table 3.6). By 1985 expenditures on urban housing enlarged per capita residential floor space by some 60%. The CESRRI investigators noted that<sup>44</sup>

In recent years, as local governments gained new powers over investment, local investment has been used increasingly for nonproductive projects. . . . Local governments have rapidly increased the share of their direct investment in fixed assets invested in nonproductive projects such as urban renovation, housing construction, and scientific, educational, cultural, and public health undertakings. This tendency may continue. "Building a beautiful city" has become a major objective of local governments.

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<sup>44</sup> Reynolds, Reform in China, p. 109. See also pp. 12-14, 88, 116.

Moreover -- disconfirming the the assumption that base-level managers and local officials would invest more in accordance with a market logic -- the researchers noted that "the lower the level of government, the larger the proportion of investment in nonproductive projects."<sup>45</sup> Now, it is hardly surprising that, after decades in which expenditures on urban, especially workers housing had been spare while the urban population swelled, "building a beautiful city" has won the enthusiastic support of China's workers. By contrast, however, the reform leadership in Beijing has increasingly viewed such tendencies with alarm, because the leadership is not interested in using market reforms to create a welfare state, but to get economic development, and this requires regular and more effective reinvestment of the surplus back into production. From this perspective, the propensity of industrial managers and local official to divert more and more resources from production to consumption, and their general "lack of enthusiasm for long-term projects of a technologically revolutionary nature" has been subversive of the reformers goals.<sup>46</sup> In recent years, the leadership has

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<sup>45</sup> Ibid., p. 109.

<sup>46</sup> The quote is from ibid. p. 113.

been particularly critical of excesses in "institutional" consumption. Speaking to the National People's Congress in March 1987, Zhao Ziyang warned the assembled cadres that:<sup>47</sup>

Many government offices, enterprises, institutions and public bodies squander large amounts of public funds, indulging in ostentation and extravagance, vying with each other in luxury, giving lavish dinners and gifts, issuing excessive subsidies in kind and seeking unjustifiably high standards in all construction projects. Excessive increases in wages and bonuses and in group purchases have pushed up production costs . . . In the past few years production of many high-priced consumer durables has greatly increased, and much foreign exchange has been expended on importing large numbers of whole machines and parts . . . This trend of consumption pattern is incompatible with China's current level of economic development . . . Unless correctly guided, it will result in reduced accumulation of funds and make continued economic growth difficult.

This is the reason why, as we shall see below, that despite their stated goal of decentralization, the reform leadership has intervened time and again in the economy to recentralize control over surplus expenditures.

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<sup>47</sup> "Report on the work of government," Beijing Review, April 20, 1987, p. .

**Table 3.6: Investment in Capital Construction:  
Productive and Non-productive**

Year	Value (Rmb. 100 million)			Proportion (Total = 100%)		
	Productive Construction (Dept. I)	Non-productive Construction (Dept. II)		Productive Construction (Dept. I)	Non-productive Construction (Dept. II)	
	Total	Total	Of which: Residential buildings		Total	Of which: Residen- tial buildings
1971-75	1,455.6	308.8	100.7	82.5	17.5	5.7
1978	396.2	104.6	39.2	79.1	20.9	7.8
1979	365.1	158.3	77.3	69.8	30.2	14.8
1980	359.3	199.6	111.7	64.3	35.7	20
1981	252.4	190.5	111.2	57	43	25.1
1985	611.3	463	215.2	56.9	43	20

Source: State Statistical Bureau, Statistical Yearbook of China 1987, p. 407.

### **Competing to Raise Wages!**

But perhaps nothing has disconfirmed the assumptions of China's reformers more than the industrial managers' attitude toward the wage bill. For it was assumed that, as part and parcel of efforts to maximize profits, industrial managers would seek to minimize the wage bill and to tie reward to performance. But this hope turns out to have misplaced. To take one example, in a study of the Chongqing Clock and Watch Company (CCWC) carried out by the

World Bank, Bank economists William Byrd and Gene Tidrick reported that after adopting reforms, CCWC indeed sought to maximize profitability in certain specific ways. CCWC "made strong efforts to increase retained profits through output expansion, new product development, and manipulation of its administrative and incentive environment." But, whereas in line with "the conventional motivational assumption in models of capitalist enterprise behavior," one would expect that a profit-maximizing firm would probably try to restrict increases in wages, bonuses, and worker amenities, "CCWC by contrast has often tried to increase worker benefits. Much of the company's effort to manipulate the rules on calculation and use of retained income has been devoted to trying to increase workers' bonus or collective welfare payments."<sup>48</sup>

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<sup>48</sup> William Byrd, et. al. Recent Chinese Economic Reforms: Studies of Two Enterprises, World Bank Staff Working Paper No. 652 (World Bank, Washington D.C., 1984), pp. 30-31 (emphasis added). This document contains two studies, the first by Byrd and Tidrick entitled "Adjustment and reform in the Chongqing Clock and Watch Company." The companion piece entitled, "Management and reform in the Qingdao Forging Machinery Plant" (hereafter QFMP), is a study of a producer goods factory. The authors of the second piece, Chen Jiyun, Xu Lu, Tang Zongkun, and Chen Lantong, are from the PRC. These studies are especially valuable because they present the first full-length systematic studies of the effects of the reforms on individual enterprises. hereafter, this work will be cited as Byrd, et. al., Recent Chinese Economic Reforms.

Again, one would have thought that, in line with a profit-maximizing logic, CCWC's management would have used its newly-won discretionary power over wages and bonuses to try to increase productivity by tying rewards more closely to performance. But in fact, Byrd and Tidrick discovered that in the Chongqing Clock and Watch Company:<sup>49</sup>

Bonuses are not very closely linked to performance, either of the enterprise as a whole or of individual workers. Slack planning enables targets to be easily met or revised, thus weakening the link between bonuses and overall performance. Individual incentives are weak because bonuses are distributed on a fairly egalitarian basis. Since targets and related bonuses are handed down to factories, workshops, and small groups, an individual's bonus payment depends as much on his work unit's performance as on his own. Only small variations between work units have occurred in the past; about 70% of workers receive bonuses within a very narrow range. Only about half the bonus fund for labor competition was distributed to individual workers in 1982. The remainder was handed out equally to all workers at the end of the year. Other bonuses have also been shared out equally.

And this pattern is not unique to CCWC. Another recent study, this time an in-depth study of twenty state-owned firms carried out jointly by the World Bank and the Chinese Academy of Social Sciences (CASS) found that the link between bonus and plan performance was so weak and negotiable that that bonus and welfare payments determined profit retention and plan targets -- instead of the other

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<sup>49</sup> Op cit. p. 28.

way around.<sup>50</sup> Indeed such tendencies toward maximizing the wage bill and toward equal distribution of wages and bonuses have been typified throughout Chinese industry since the introduction of reforms. The Chinese press has carried almost daily complaints that instead of utilizing bonuses to reward more productive employees, enterprise directors have wasted funds on an "indiscriminate" distribution of bonuses. The party leadership complained that enterprises "wantonly expand the scope for issuing allowances regardless of the intensity of labor, working conditions or environment."<sup>51</sup> Managers handed out cash rewards, sometimes equal to two months wages and more, and bonuses in kind. "Commodities are being given away under all sorts of names. A number of enterprises purchased large quantities of commodities and gave them to staff members and workers calling them year-end rewards, dis-

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<sup>50</sup> Gene Tidrick and Chen Jiyuan, eds., China's Industrial Reform, (New York: World Bank/Oxford University Press, 1987), pp. 73, 183-84. This important study is a compilation of twelve papers analyzing the impact of China's industrial reforms together with two supplementary papers surveying the East European experience with reforms. Hereafter this work will be referred to as the World Bank/CASS study, and cited as Tidrick and Chen, China's Industrial Reform.

<sup>51</sup> "The situation of wantonly giving away bonuses must be corrected," Renmin Ribao, January 25, 1979, FBIS January 26, 1979, pp. E22-23.



tributing labor safety devices or taking care of workers' living conditions. Some units issued cloth shoes, vacuum bottles and handbags to staff members . . .<sup>52</sup> Despite all their indoctrination in western "scientific management" skills, the leadership has complained that the industrial and commercial managers are actually "competing with each other in giving away higher bonuses."<sup>53</sup> According to Chinese accounts, managers are really quite devious and even prepared to go the extreme of breaking the law if necessary. They "defy state regulations," "concocted various pretexts such as relief grants and financial difficulty subsidies," and made "unauthorized fund transfers," all to hand out still more bonuses.<sup>54</sup> The authors of the CESRRI survey cited above, observed the same phenomena: "According to our investigations, the enterprises employ more than forty different methods to dodge wage control and secure more bonuses and benefit. . . [By] a rough calculation, such 'off-the-book' losses alone amount to some

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<sup>52</sup> Ibid. p. 24.

<sup>53</sup> Ibid. p. 25 (emphasis added). See also, Zhao Ziyang's "Report on the work of government" for 1986, in Beijing Review, April 21, 1986, p. XI, for further comments on this tendency.

<sup>54</sup> Xinhua, January 25, 1980, FBIS January 29, 1980 p. L6.

20 billion yuan [in 1984 --R.S.] for the whole country."<sup>55</sup> Consequently, "whether investment registers a big increase or negative growth, the consumption funds increase irreversibly."<sup>56</sup> What's more, the government reports that bonuses have been excessively distributed not only by money-making enterprises, but even "those units whose management was a mess and who not only failed to turn in profits to the state but suffered financial losses also issued bonuses."<sup>57</sup>

The not very surprising result of this is that the wage bill has grown enormously despite the fact that productivity has not. The CESSRI researchers noted that "The

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<sup>55</sup> Op. cit., p. 10. Many of these methods are detailed on pp. 10-11, 19, 91 & 97.

<sup>56</sup> Ibid., p. 97.

<sup>57</sup> "Correctly implement the bonus system in line with the principle of 'to each according to his work,' " Renmin Ribao May 18, 1979, FBIS May 21, 1979, pp. 17-18. Byrd and Tidrick noted that Chongqing Clock and Watch "managed to spend more than its stipulated share of retained profits on collective welfare plus bonuses during the entire period 1980-82, and it has taken advantage of opportunities to pay special bonuses from profits despite attempts to restrict such payments." Moreover, when the 1979-81 overexpansion gave rise to overproduction in 1982, and the state intervened to restrict output, the firm's response "reached new heights of ingenuity" in the attempt to continue raising consumption despite mounting losses. Op.cit., p. 48.

growth rate of consumption funds has been higher than the growth rate of national income in every year since 1979." In just one year, 1984 for example, labor productivity increased by 7.8% but wages grew by 22.3%.<sup>58</sup> For the most part enterprises have spent the bulk of their retained profits not on individual bonuses but on collective welfare expenditures, especially housing and amenities for staff and workers. Chongqing Clock and Watch, for example, spent 60% of its retained profits in this way, and this was three times the amount distributed as bonuses.<sup>59</sup>

In sum, instead of linking rewards more closely to performance, it seems that the reforms simply replaced the egalitarian low wage of the Mao era with an egalitarian high wage. Today, as before the reforms, industrial managers do not seek to maximize profits -- they seek to maximize enterprise income, by maximizing all inputs, including the wage fund. Consequently, although the reform leadership has often stated its intention to lower the ratio of accumulation to consumption in order to improve

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<sup>58</sup> Reynolds, Reform in China, p. 91.

<sup>59</sup> Byrd and Tidrick, op. cit. p. 29, annex A, p. 9. Between 1977 and 1981 the average income (wages and bonuses) of permanent employees increased by 87% while average collective welfare expenditures per employee doubled. p. 41.

living standards, given the tendencies just described, it was not long before the reformers renewed the call for greater accumulation.<sup>60</sup> In June 1983, State Planning Minister Yao Yilin, warned that<sup>61</sup>

It was imperative in recent years to increase substantially the investment in housing and urban public utilities in order to solve problems accumulated over the years. However, continuing to allow a high percentage of capital construction investment to be used for nonproductive purposes will hamper the normal process of expanded reproduction.

In March 1985, Zhao Ziyang warned the workers, as previously the peasants, that the government could no longer afford to increase consumption: "In recent years, the average wages of our workers and staff have already risen faster than increases in labour productivity and national income. This will remain the case in 1985. From the point of view of macroeconomic balance, we have

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<sup>60</sup> A May 19, 1983 Renmin Ribao editorial noted that "In the past, because of defects in the economic system, the central authorities exercised too much and too rigid centralization, and the local authorities and enterprises lacked the requisite financial means for active operation. . . But it is absolutely not feasible to talk only about affluence of the people and enterprises without respect for affluence of the state (emphasis added). pp. 1-2, FBIS May 23, 1983, p. K8.

<sup>61</sup> "Report on the 1983 plan for national economic and social development," delivered at the First Session of the Sixth National People's Congress, June 7, 1983, in The First Session of the Sixth National People's Congress (Beijing: Foreign Language Press, 1983), p. 73.

already done all we can with regard to wage increases. Obviously, further increases would be unrealistic and out of the question at present and would be at variance with the people's long-term interests."<sup>62</sup>

### **Immobilized Labor**

Reforms also failed to break down the rigid system of state allocation of labor, which even today, remains more rigid than in the Soviet Union or East Europe. Until recently, all urban school-leavers were administratively assigned to particular jobs -- college graduates by the central government, secondary school graduates by local labor bureaus -- with little attention to their preferences, or for that matter, the preferences of their employers. The assignment was, typically, for life. Enterprises, moreover, were not permitted to discharge workers, even if they were redundant, or even if particular individuals were habitually absent, lazy or negligent.<sup>63</sup> In the last few years, reforms have altered this situation somewhat. The system of compulsory assignment has reportedly been dropped for some categories of unskilled

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<sup>62</sup> "Report on the work of government," delivered March 27, 1985, and published in Beijing Review, April 22, 1985, p. IX.

<sup>63</sup> World Bank, China: Long-Term Development Issues and Options, p. 131.

labor, and enterprises may now "examine" and in some cases reject prospective employees. Some jobs are now advertised. Starting in 1984, some new workers have been hired on the basis of "job contracts" between enterprises and new employees, often for three to five years, specifying mutual obligations in regard to wages, performance standards, contract renewal, and severance. Finally, there has been rapid growth of the commune and brigade and individual enterprise sectors, where employment decisions are subject to little administrative regulation. Yet, in the words of the World Bank:<sup>64</sup>

These and other reforms, though beneficial, have not basically changed the system. The unified assignment scheme is still used for virtually all those with any postsecondary training and for some skilled manual workers. Enterprises can seldom hire badly needed skilled workers from other enterprises where their skills may be less valuable; they are still obliged by the labor bureaus to accept "packages" containing both wanted and unwanted recruits; they cannot discharge redundant workers; and they have been allowed to dismiss unsatisfactory workers only in a few instances, involving extreme absenteeism or malfeasance. It appears imperative to consider further, more radical, changes.

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<sup>64</sup> Ibid.

### II.C. From Autarky to Specialization and Production for Exchange?

It was also hoped that decentralization would break down the long established patterns of geographical, ministerial, departmental and enterprise vertical integration and self-sufficiency -- what the Chinese call "big and all-inclusive" and "small and all-inclusive" (da er quan, xiao er quan). As we noted in chapter one, starting in 1978 the reformers introduced several reforms designed to break down the vertical structure and compartmentalization of the economy with all its redundancies and inefficiencies, and promote and increased specialization, division of labor and horizontal exchange, especially via marketization. Many mandatory output targets were replaced with supposedly non binding "guidance" targets. The state reduced the number of goods under unified distribution from 211 to 64. Enterprises and materials bureaux were directed to sell off excess inventories, and firms were encouraged to sell their above quota output on the free market. The ban on barter deals between enterprises was lifted, and various restrictions on inter-regional trade were lifted. Prices of many products were freed up to float within a range of 20 percent above or below the state price, and numerous "materials exchange fairs" (wuzi jiaoliuhui) were organized to promote exchange.

Now there is no doubt that this relaxation of central planning has significantly increased horizontal resource flows in the Chinese economy.<sup>65</sup> In particular, the increased availability raw materials, fuel and machinery outside planned channels has greatly facilitated the growth of consumer goods production. Chief beneficiaries have been the small-scale, local industries which can now purchase equipment and key materials formerly allocated to larger production units at higher levels.<sup>66</sup> And these have contributed substantially to the increased availability and variety of consumer goods from clothing and textiles to bicycles, watches, radios and televisions.

But its easy to overstate the extent of these developments, and they have often been exaggerated by Western journalistic and academic enthusiasts of market reforms, who have taken these reforms to signal the impending demise of central planning and its replacement by the market. While there is no doubt that the reforms resulted

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<sup>65</sup> For one analysis of this impact see William Byrd, "The role and impact of markets," chapter 10 of Tidrick and Chen, eds., China's Industrial Reform, pp. 237-75.

<sup>66</sup> Christine Wong, "Material allocation and decentralization: impact of the local sector on industrial reform," in Perry and Wong, eds., The Political Economy of Reform in Post-Mao China, (Cambridge, Mass: Harvard University Press, 1985), pp. 268-9.



in a sharp decentralization of planning (paralleling the fiscal decentralization of the same period), it is altogether another question whether planning itself is being superceded by the market, or whether the reforms have significantly lessened tendencies toward self-sufficiency and redundant (duplicate) production. In my estimation, the reforms have had little impact on these problems.

To begin with, central planning has never been as comprehensive in China as for example in the Soviet Union. The number of materials centrally allocated has never exceeded 500-600 until recently, compared with some 65,000 in the Soviet Union.<sup>67</sup> This has meant that Chinese enterprises have rarely had all their sources of supplies specified for them in their purchasing plan, and they have always had to procure a portion of their planned inputs on their own -- through goods ordering conferences, independent procuring agents, and informal barter trade.<sup>68</sup> In the

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<sup>67</sup> Christine P. Wong, "Ownership and control in Chinese industry: the maoist legacy and prospects for the 1980s," in J.E.C., China's Economy Toward the Year 2000 (U.S. Government Printing Office: Washington D.C., 1986), vol. 1, p. 577.

<sup>68</sup> Andrew G. Walder, "The informal dimension of enterprise financial reforms," in J.E.C., China's Economy Toward the Year 2000, p. 636.

spirit of reform, go-getting officials have very often quite simply renamed such long-established state conferences "commodity markets" and counted informal barter there and elsewhere as "market exchange" -- but this does not ipso facto mean that these are "markets" or that such exchange is "at value."

In reality, contrary to all the propaganda, there has been no broad shift to marketization. Central planning of production still overwhelmingly dominates China's industrial economy and "the basic framework of the original supply and marketing system for state enterprises has fundamentally remained intact."<sup>69</sup> Marketization in China exists at the periphery to "fill in the cracks" as it does elsewhere in other bureaucratic economies. Plan output targets, for example, have been reduced but by no means not abolished. Before the reforms, enterprises were required to meet eight to ten binding targets (or in the event of conflict, the gross value of industrial output and the physical output were the most important). Most enterprises now receive four: gross value of industrial output, physical output of main varieties, quality and profits. Enterprises therefore still face mandatory plan

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<sup>69</sup> Tidrick and Chen, eds., China's Industrial Reform, p. 232.

targets as before. Moreover, it turns out that "guidance plans" are also often binding -- if the enterprise wishes to obtain necessary inputs.<sup>70</sup> Since the Chinese do not publish comprehensive data for the planned vs. marketed share of industrial output, estimates vary. The CESRRI study of 429 enterprises showed that in 1984 state materials-supply agencies directly allocated 73% of the raw and semi-finished materials inputs of the firms, while planned procurement by state agencies accounted for 67% of these firms output. Thus by this estimate, state enterprises self-market at most about one-third of their output.<sup>71</sup> This figure probably overestimates the extent of self-marketing since in practice it is reported that "a considerable share of self-marketed output is allocated by government agencies or virtually requisitioned by such powerful organizations as the railways and power

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<sup>70</sup> On the distinction between mandatory and guidance planning see Robert Dernberger, "Economic policy and performance," in J.E.C., China's Economy Toward the Year 2000, vol. 1, pp. 18-19, notes 4 and 6; and Tidrick and Chen, eds., China's Industrial Reform, p. 179.

<sup>71</sup> Reynolds, ed., Reform in China, p. 48. See Tidrick and Chen, eds., China's Industrial Reform, pp. 247-8 for comparable data on the 20 firms studied by the World Bank/CASS.

bureaus."<sup>72</sup> A more conservative estimate, by the University of Michigan economist Robert Dernberger, puts the share of self-marketing by state-owned firms at about 25%.<sup>73</sup> Taking the economy as a whole (that is, industry and agriculture), Dernberger concludes that the private-collective/market sector of the economy had increased, but by the mid-eighties was still smaller than it was during the early 1950s and early 1960s.<sup>74</sup> Whether the true share of self-marketed industrial output is closer to a quarter or a third of industrial output, it is still true that after nearly a decade of reform, central planning remains overwhelmingly dominant in the industrial economy. In the words of Professor Dernberger, "China's economy today remains a Soviet-type economy and is much more typical of a Soviet-type economy than many Western observers or China's leaders themselves would lead us to believe."<sup>75</sup>

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<sup>72</sup> Tidrick and Chen, eds., China's Industrial Reform, p. 249.

<sup>73</sup> J.E.C., China's Economy Toward the Year 2000, vol. 1, p. 30.

<sup>74</sup> Ibid. p. 28.

<sup>75</sup> Ibid., p. 20.

Yet, the question of the present magnitude of industrial production for market is not so critical as is the reformers' response to what free market activity there is. And this is, I believe, far more indicative as a guide to future trends than the pro-market rhetoric from Beijing. In this respect, one must ask why it is that, given the leadership's calls for greater marketization, the most salient trend since the introduction of these reforms has been resistance by the reformers to decontrol of factors which would be essential to any significant marketization, and the persistence of state intervention in the economy -- precisely to counter incipient market tendencies.

**Limits to Self-Marketing:  
The Reformers' Ambivalent Attitude to Production for  
Market**

This paradoxical situation is perhaps most evident with respect to the development of self-marketing. While the reforms gave many (though by no means all) industrial producers the freedom to market over-plan output, this has often proved difficult if not impossible to do, because the reformers have thus far refused to free up markets for crucial factor inputs: labor, land or capital which would be necessary for such ventures. These are still virtually entirely allocated through the planning apparatus. Even inputs of raw materials and energy (most crucially, electricity) supplies are still mostly to entirely monopolized by the state. Therefore, should a firm manager wish to

expand output or change the firm's product mix to take advantage of market opportunities, the would-be entrepreneur faces formidable obstacles because critical inputs necessary for such expansion or restructuring have not been allocated in the firm's original plan.<sup>76</sup> This was the case, for example, with Chongqing Clock and Watch Company. In its expansionary phase, from 1979 to 1981, CCWC sought to meet rising demand by hiring more skilled labor and getting more space for production facilities. But it could not simply go out and hire additional workers, especially skilled workers, because there is no significant industrial labor market in China, nor could it rent additional space, because factory buildings are not for rent in China. Eventually, the enterprise was only able to get around these restrictions indirectly, by negotiating a political-administrative merger with other subsidiary production units, and also a local commune -- so as to use their labor and space for its own expanded reproduction. However, when demand fell off in 1982, it faced the opposite situation -- its superior authority would not let the firm disengage itself from the administratively reorganized structure, and therefore CCWC could not lay

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<sup>76</sup> For a discussion of these constraints see Tidrick and Chen, eds., China's Industrial Reform, pp. 67-9, 76-80, 91-2, and 188-90.

off its by then redundant workforce. Instead, it was obliged to continue to pay these extra 380 workers while they were put on "study leave" -- to the detriment of the firm's profit picture.<sup>77</sup> And this company, it should be noted, was said to be one of China's most advanced reformed enterprises. CCWC's experience was, moreover, not untypical.<sup>78</sup>

Furthermore, it is often the case that even those firms which were nominally granted the right to market their over-quota output, found that in practice this right was highly insecure and tended to be affirmed or withdrawn according to changes in supply and demand. For example, the proportion of steel production that producers were allowed to market was increased from 4% in 1979 to 11% in 1980 and 20% in 1981, before being reduced to 14% in 1982, and 4% in 1983.<sup>79</sup> When supplies are sufficient, and particularly when there is a situation of oversupply, the state has permitted, even pressured overproducers to self-

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<sup>77</sup> See Byrd et. al., eds., Recent Chinese Economic Reforms, pp. 18, 20, 27, & 63.

<sup>78</sup> See Tidrick and Chen, eds., China's Industrial Reform, pp. 188-96, for other examples.

<sup>79</sup> Tidrick and Chen, eds., China's Industrial Reform, pp. 232, 234.

market their excess output, often by instructing state purchasing agents or commercial distributors to refuse to buy the producers' excess output. In such cases, producers were sometimes able to respond by direct marketing or by tying sales of excess goods to those in high demand.<sup>80</sup> But when the firm's product is in short supply the state has tended to intervene to requisition such goods and allocate them to priority uses (and confiscate the potential profits in the process).<sup>81</sup> Some firms have faced both situations. For example, during the state-led retrenchment of the early 1980s when production targets were cut back, China's No. 2 Auto plant was instructed to self-market about half its output in 1981 -- which with some difficulty it succeeded in doing. But when demand picked up again in late 1982, superior authority required the plant to turn over all its output for centralized distrib-

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<sup>80</sup> The World Bank analysts found several instances of this sort of response, a prominent example being Chongqing Clock and Watch Co., which, when faced with the refusal of its commercial agent to buy up all its output, turned some of its workers into salesmen and sent them out to market its surplus watches. Byrd, et. al., Recent Chinese Economic Reforms, p. 51. See also Tidrick & Chen, China's Industrial Reform, pp. 232-4, 242, 247, 249-50; and Byrd, The Shenyang Smelter, pp. 55-8.

<sup>81</sup> Ibid., p. 249.



ution.<sup>82</sup> Similarly, management at the Shenyang Smelter complained that the enterprise is forced to market its own goods that are in excess supply, while material supply authorities insist on distributing all production of goods in short supply.<sup>83</sup>

Lastly, although firms are now permitted to barter for needed inputs and to purchase above-quota supplies from the self-marketed output of other producers, not all materials can be obtained in this way, and, as the World Bank/CASS study pointed out: "Even where firms can and will pay high negotiated prices, the state objects because the practice reduces profits and revenue (this is only true, of course, if profits of sellers are taxed more lightly than those of buyers, or if sellers understate their revenues -- a likely occurrence)." Consequently, the state has tried to prevent both sellers and buyers from exceeding negotiated price limits in excess of 20 percent above the controlled price.<sup>84</sup> Even in cases where the exchange is a simple barter between firms and no profit is

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<sup>82</sup> Tidrick and Chen, eds., China's Industrial Reform, pp. 233-4.

<sup>83</sup> Byrd, The Shenyang Smelter, p. 55.

<sup>84</sup> Tidrick and Chen, eds., China's Industrial Reform, p. 193.

involved, the state resists such exchanges when they conflict with the central plan. Thus, for example, when the Shanghai No. 17 Cotton Mill arranged a barter deal in 1983 with another firm to exchange its overstock of high-quality cotton for a needed quantity of low-quality cotton, superior authority blocked the deal:<sup>85</sup>

Shanghai Cotton was criticized by the department concerned because the exchange undermined the national allocation plan for cotton. The company was warned that no such exchange would be permitted in the future. The supply agencies cannot allocate materials to suit the needs of individual enterprises. Nevertheless, they insist that enterprises stick to convention at the expense of efficiency.

So, to sum up: In the context in which plan quotas are still imposed, in which critical factors of production are not available on the market, in which higher administrative departments can withdraw the partial delegation of marketing rights at any time, and in which profit-making firms see their profits confiscated (in effect for redistribution to support unprofitable enterprises), it is hardly surprising that industrial managers rather consistently "fail to learn" appropriate market behaviour and instead of specializing, shedding excess stocks and labor, and orienting to the market, more often than not they continue to pursue strategies of self-sufficiency, striving

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<sup>85</sup> Ibid. p. 218.

to hoard supplies, to secure captive high-cost sources of supply, and to engage in bureaucratic competition and manipulation (instead of market/economic competition) to secure investment funds, materials and equipment, and energy supplies, and to guarantee sales.<sup>86</sup> So in some respects the growth of a limited free market for some inputs has rendered it less necessary for many factories to be quite as self-sufficient as in the past.<sup>87</sup> But for the most part, it appears that the reforms have actually reinforced tendencies toward self-sufficiency, "departmentalism" (benwei zhuyi) and "localism" (difang zhuyi). An important reason for this is that while the "partial" reforms have been insufficient to create real markets, fiscal decentralization has given the factory directors the resources to reinforce their own capacities for self-sufficiency. So, since the introduction of reforms in 1978, factory directors have tended to use their newly-won

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<sup>86</sup> For some examples in the petrochemical, auto, and machinery industries, see Tidrick and Chen, eds., China's Industrial Reform, pp. 202 and 222-23. This failure to adopt and consistently hold onto market-oriented behavior patterns has been a frequent lament of World Bank development economists. See e.g. op. cit., pp. 266-8, and Byrd et. al., Recent Chinese Economic Reforms, pp. 48-9, 60-4.

<sup>87</sup> See Tidrick and Chen, eds., China's Industrial Reform, pp. 195-6, for examples, although even Tidrick cautions that "this change should not be overstated." Ibid., p. 206.

powers to pursue even more effectively their traditional strategies of vertical integration and technological autarky.

For example, many preferred to invest their retained profits in adding in-house machine shops for example, rather than specializing and thereby being forced to rely on other producers, and many preferred to purchase new equipment of current technological level rather than risk a breakdown in output by adopting more sophisticated technology with as yet unproven reliability.<sup>88</sup> Before long, it was evident that tendencies toward enterprise autarky and duplication were growing instead of diminishing so that by the end of 1980, the government complained that "this problem has worsened in the past two years."<sup>89</sup> By the

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<sup>88</sup> See Baum, ed., China's Four Modernizations; and Richard P. Suttmeier, "Research, innovation, and the Chinese political economy," in J.E.C., Under the Four Modernizations, pp. 489-513.

<sup>89</sup> Renmin Ribao, December 25, 1980, p. 2, FBIS January 8, 1981, p. L19. In October 1979, it was reported, for instance, that in Shanghai, "while there are already 60 units turning out steel windows whose total productive capacity exceeds demand by a third, another 11 units in the city have built steel window workshops this year. In Lanzhou area, there were 23 sets of electronic computer equipment as of the end of 1978 with a utilization rate of only 20 to 30 percent. This year six units in the area started electronic computer projects and another three have filed applications to build similar projects. There are 15 auto repair shops in Chengdu Municipality . . . Last year they [operated] almost 40% below capacity. . . However the Ministry of Posts and Telecommunications is building new auto repair shops in Chengdu and has already spent some Y600,000 of its planned [budget] of Y3.6 mil-

spring of 1981 it was reported that in the machine-building sector, for example,<sup>90</sup>

almost all machine works have been turned into "comprehensive complexes both large and small." According to statistics, about 80% of the some 6,000 enterprises under ownership of all of the people at and above the county level and under the First Ministry of Machine-Building are "comprehensive complexes." More than 1,000 of the 1,400 major machine works are "comprehensive complexes." Most of the 4,000 auxiliary plants and assembling and accessory plants are "comprehensive complexes of a medium or small scale." These problems are inappropriate to the needs of socialized mass production, seriously hinder the technical improvement and the increase of labor productivity of the machine-building industry and are incompatible with the market needs at home and abroad.

#### **Bureaucratic Competition via "Market Blockades"**

The same tendencies were felt throughout the broader local and regional economies. For, paralleling the profit-sharing schemes in industry, in 1980 the state introduced revenue-sharing schemes that gave the provinces and their subunits, the counties, the right to retain all or a portion of the revenues accruing from enterprises within

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lion!" Xinhua October 12, 1979; FBIS October 15, 1979, p. L9.

<sup>90</sup> Wenhui Bao, April 18, 1981, p. 3, FBIS April 23, 1981, p. W2.

their boundaries.<sup>91</sup> As with the enterprises themselves, this reform gave the localities and provinces a strong incentive to maximize revenue and employment-generating activities within their sphere. Moreover, local and provincial governments naturally sought to promote those industries which have the greatest rates of profit -- typically, consumer goods such as watches, bicycles, textiles, liquor and tobacco. This led to a massive surge in investment and duplication in these high-profit industries.<sup>92</sup> And this in turn exacerbated problems of local protectionism, and increased resistance to inter-regional trade.<sup>93</sup> Local governments have sought to capture and maximize their share of locally generated profits and taxes both by forcing sales of locally made products within their administrative boundaries and preventing com-

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<sup>91</sup> See Perry and Wong, eds., op. cit., p. 268; and Audrey Donnithorne, "New light on central-provincial relations," The Australian Journal of Chinese Affairs, no. 10 (1983), pp. 97-104.

<sup>92</sup> Wong, "Material allocation," in op. cit., pp. 269-70; and Tidrick and Chen, eds., China's Industrial Reform, p. 191.

<sup>93</sup> Wong, "Material allocation," op. cit., pp. 273-75.

peting localities from entering their their markets,<sup>94</sup> or, by setting up local small-scale processing operations to insure that taxes from finished products are paid locally instead of accruing to higher levels, as would otherwise be the case. For example, given high profit and tax rates for cigarette and liquor manufacture, local officials have sought to process them locally rather than pass on the raw material to larger-scale operations in the big industrial cities.<sup>95</sup> For the same reason, local governments are extremely protective of "their own" industries and strongly resisted outside competition from undermining local firms -- because to allow such "foreign" competition to cause a loss of sales or force the shutdown of a local producer means the "export" of local government revenues earned by it.<sup>96</sup> So decentralization certainly promoted competition -- but hardly the sort the reformers had in mind.<sup>97</sup>

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<sup>94</sup> Tidrick and Chen, eds., China's Industrial Reforms, pp. 258-59.

<sup>95</sup> Wong, "Material allocation," op. cit., pp. 273-74.

<sup>96</sup> Tidrick and Chen, eds., China's Industrial Reform, pp. 256-9 and 273, note 27.

<sup>97</sup> Professor Susan Shirk noted that "Economic competition has increased, but competition is still waged with the techniques of bureaucratic warfare rather than market competition." "The politics of industrial reform," in Perry and Wong, eds., Political Economy of Reform, p. 204. See Shirk's discussion of the balkanization of markets with

Thus into the second year of the reforms, the economist Xue Muqiao noted with concern that "the error of blindly seeking growth basically remains unchanged," and "symptoms of setting up 'separatist regimes' have already appeared in some places. The upper and lower departments there are not only scrambling for benefits but are also obstructing the horizontal development of the economy. If these symptoms are allowed to develop freely, the economy will be regressing, not advancing."<sup>98</sup> Instead of shedding excess stocks, enterprises and localities used their new resources to accumulate still more stock. In July 1983, five years after the introduction of reforms, Chinese economists discovered that<sup>99</sup>

dispersed finance brings about dispersed goods and materials. It is very common now for all units at various level to have their own warehouses. Consequently, localities, departments, and enterprises have enormous stocks of goods in their hands. The amount of materials such as steel, timber, and cement that are under state unified distribution that are in the hands of the localities, departments and enter-

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the onset of reform, ibid., pp. 195-221.

<sup>98</sup> "Some opinions on reforming the economic system," op. cit., p. 5 (emphasis added).

<sup>99</sup> Zhou Chuan, "Realistically emphasize key projects," Jingji Guanli no. 7, July 5, 1983, pp. 9-11, JPRS no. 84262, September 7, 1983, p. 83.



prises respectively number 75%, 57%, and 32% of total social resources.

Given the difficulty of obtaining resources through normal supply channels, the enterprises and localities have had little choice but to produce themselves what they couldn't get allocated, to hoard difficult to obtain items and even stockpile items they don't actually need as barter for future exchange. In the effort to maximize local income and revenues, and to prevent competition, localities set up "market blockades" (shichang fengsuo). In 1978, it was reported that<sup>100</sup>

in recent years more and more wholesale agencies have been set up according to administrative districts. In 1963 there were more than 900 second-level wholesale stations (there were three levels of wholesale stations from the central to county level) throughout the country, but now their number has increased to more than 1,500. In some cities, we can even find prefectural, municipal and county wholesale stations. Each of the goes its own way. They scramble for goods and set up obstacles between themselves. As a result, large quantities of commodities are stockpiled, the turnover of funds is very slow and operational costs are high.

An article in the May 14, 1980 issue of Jiefang Ribao described the curious and unexpected mode of "socialist competition" that developed with the reforms:<sup>101</sup>

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<sup>100</sup> Ibid. p. E20.

<sup>101</sup> Kang Xuewen, "Study the new circumstances and new problems in market readjustment," p. 4, JPRS July 21 1980, pp. 22-23. (emphasis added).

In order to increase the area's local financial receipts, some localities put forward the principle of "first within the province, then outside the province," and limited outward shipment of local commodities, specifying that anything that the province or locality could produce, no matter how good or poor the quality, no matter how high or low the production cost, could not be ordered from outside the province, and also limited sales by enterprises from outside the area. In order to achieve a monopoly or a favorable position in competition, some enterprises closed their doors to each other in regard to product design or process technology, which was unfavorable to the pursuit of socialist cooperation and to technical advancement and development.

In August of the same year, Xinhua reported that "With the expansion of enterprises' self-management power and the regulation of production by the market, various trades and enterprises have gradually begun to compete with one another. . . . However, some units have adopted various measures to restrict competition, restrain the advanced and protect the backward."<sup>102</sup> To try to get around the rigidities of the structure of vertical allocation of resources and facilitate the horizontal exchange of producer goods between administrative and production units, the government established numerous "materials exchange fairs" (wuzi jiaoliuhui).<sup>103</sup> But this too has often been

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<sup>102</sup> August 7, 1980, FBIS August 13, 1980 p. L11-12.

<sup>103</sup> The economist Xue Mugiao explained the government's conception of the role of trade fairs as follows: "Bureaus, companies and enterprises can all put up lists or advertisements giving details of the goods which have been stored in their warehouses for a long time and can sell them at the fair. Bureaus, companies and enterprises in need of these goods need not go through the red tape of

defeated by local authorities.

Commenting on one such trade fair held in Tianjin March and April 1980, a Xinhua correspondent noted that:<sup>104</sup>

At the newly opened capital goods market, more than half the goods sold were produced in Tianjin. However, when transactions were concluded or contracts for goods were signed, leading administrative organs in some areas, in the name of "protecting local industry and commerce" . . . prohibited the purchasing of advanced products from other parts of the country. Some areas used such means as banks refusing to pay for the products purchased and not supplying fuel to the buyers to force them to cancel the contracts and to return the products already bought.

In its efforts to abolish such practices and foster market competition and exchange, the State Council in 1980 decreed that<sup>105</sup>

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submitting applications to the Goods and Materials Bureau, nor do they have to send purchasing officers running everywhere. They can easily satisfy their needs at the fair. . . This is very convenient." "Reform the economic structure and economic system," Hongqi no. 14, July 16, 1980, pp. 6-15, JPRS no. 76503 September 26, 1980, pp. 24-25. A history of the decentralization of materials allocation can be found in Wong, "Material allocation," in op. cit., pp. 254-78.

<sup>104</sup> August 7, 1980, FBIS August 13, 1980, pp. L11-12. (emphasis added).

<sup>105</sup> "Provisional Regulations Concerning the Development and Protection of Socialist Competition," Point 6 (adopted by the State Council October 17, 1980). translated in Almanac of China's Economy 1981 p. 221. Point 4 further states that: "Channels of commodity circulation shall be increased to open ground for competition. In principle, an enterprise may market products that are its own in excess of the planned target, those turned out with raw and processed materials arranged by itself, and goods it has

regional blockades must be broken and the partition of the market by different departments must be stopped. No area or department is allowed to enforce a blockade or to forbid the sale of outside products in its own area or department. It must ensure the export of raw and processed materials it produces according to the state plan, and any blockade is impermissible. To facilitate competition, the departments in charge of industry, communications, finance and trade must revise that part of existing regulations and rules which hinders competition. It is illegal to adopt administrative means to protect the backward and to restrict the advanced, obstructing the normal circulation of commodities; such practices must be abolished.

But such admonitions appear to have had little effect. In March 1982, Zhao Ziyang had called for a struggle to "resolutely correct the practice of enforcing eco-

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trial-produced. Goods in short supply and those to be purchased, marketed and allocated exclusively by the state must be first of all purchased by the state. The enterprise may be permitted to market a portion of certain products itself. The prices of the products thus sold should be fixed according to the relevant stipulations. Distribution channels shall be increased while the number of intermediate links reduced. The enterprises shall be permitted to use various distribution channels and to reduce the number of intermediate links, to adopt diverse forms of operation to link up production with demand and to speed up the circulation of commodities. With a view to promoting the marketing of their goods, enterprises of a certain area may set up marketing offices in other areas, hold trade fairs there, or commission others to act as their agents. Urban enterprises may do the same in rural districts an vice versa.' Ibid. See also the discussion of this problem, and the systematic presentation of the reforms leadership's alternative, in Liao Jili, "A talk on structural reform in terms of horizontal and vertical integration," Renmin Ribao, August 26, 1980, p. 5.

conomic blockades between one district and another," and issued another plea for free trade across administrative divisions.<sup>106</sup> But by the next year nothing had changed. The economist, Xue Muqiao, wrote in the June 3, 1983 edition of Renmin Ribao that:<sup>107</sup>

In recent years, the power of localities to act autonomously has been expanded, and the system of "eating in one's own kitchen," has been practiced in finance; in order to increase their own financial revenues, the various localities have neglected the question of whether it is in conformity with the needs of the whole nation, and blindly developed the processing industry which has the greatest profits, resulting in repeated construction; they even go so far as to refuse the sales of high quality products of other places in the local commercial departments, with a view to guaranteeing a market for their own products, with the effect of carving up the regions.

In the same month Zhao issued yet another plea that the work of "removing barriers and blockades" be "started" in the advanced cities and regions.<sup>108</sup> But evidently this

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<sup>106</sup> "Several questions on the current economic work," a report delivered to the national industrial and communications work conference in Tianjin, March 4, 1982, Xinhua, March 30, 1982, FBIS April 1, 1982, p. K6.

<sup>107</sup> "China's current economic situation -- analysis and prospects," FBIS June 13, 1983, p. K39.

<sup>108</sup> "Report on the work of government," delivered at the First Session of the Sixth National People's Congress, June 6, 1983, trans. in The First Session of the Sixth National People's Congress, (Beijing: Foreign Language Press, 1983), pp. 39-40.

had little impact because the next year the government felt compelled to insist that "the time had come to apply the principle of the 'open door' to the interior of China." Cooperation between provinces and and regions is essential to solving the problems arising from the uneven distribution of technology and natural resources, argued the People's Daily, and "at present, this is of greater significance than opening up to the outside world."<sup>109</sup>

#### II.D. Persistent Technological Stagnation

Closely bound up with the problem of enterprise self-sufficiency and redundancy was the chronic problem of technological stagnation in industry -- both the lack of pressure within the system to compel innovation and technical revolution, and the resistance within the system to the spread and adoption of such new technologies as already exist and are in use in some plants. The latter phenomenon was thought to be especially paradoxical because, the Chinese leadership assumed that under socialism, in contrast to capitalism, enterprises would have no proprietary vested interests in keeping technological secrets and withholding their spread. But the facts proved the opposite.

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<sup>109</sup> Renmin Ribao, March 7, 1984.

By the late 1970's much, if not most of China's industrial stock had become obsolete, and China was falling ever further behind the West technologically. A survey by the First Machine-building industry in 1980 revealed that 25% of China's machine and power equipment was at the technological level of the 1940's, 40% at level of the 1950's, 30% at the level of the 1960's, and only 5% was at the level of the 1970's.<sup>110</sup>

### **"The Reproduction of Antiques"**

Chinese economists attributed this failure to renew and upgrade factory equipment to the fact that, in the past, enterprises often were legally permitted to retain too small a portion of their profits to enable them to regularly upgrade their facilities, because they were obliged to turn over most or all their profits to the state, which would reinvest the surpluses as it saw fit -- and as often as not, this did not correspond with the needs of the enterprises. Under the old system, therefore, enterprises were often left with no choice but perpetually to repair old equipment, or as the economist Sun Yefang put it, to "reproduce antiques," even when purchasing new

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<sup>110</sup> Jingji Guanli no. 6, June 15, 1980, pp. 8-12.

more advanced technology was cheaper as well as more efficient.<sup>111</sup>

The reforms were supposed to have changed all this. The original 1978 "30 Points on Accelerating Industrial Development," and a string of State Council Resolutions before and after, all emphatically stressed the need to "mainly rely on existing enterprises" and "tap potential, renovate and transform existing technology."<sup>112</sup> And the government increased the firm's financial capacity to do so. Enterprises were encouraged to use their retained profits for technical transformation. The government increased the firms' funds specifically earmarked for technological renovation by raising the rate of depreciation of fixed assets by 20%, to 5%, and in addition, the state offered loans and subsidies designated for this purpose.<sup>113</sup> Meanwhile, the pressure of socialist competition

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<sup>111</sup> See Sun Yefang, "On the necessity of reforming the equipment management system that 'reproduces antiques and freezes technological progress,' " Hongqi no. 6, June 1, 1979, pp. 24-31. This is the most systematic treatment of the problem, but see also, Xue Muqiao, "It is necessary to reform our structure," op. cit., pp. 16-24.

<sup>112</sup> "30 Points" chapters 17 and 22; "State Council Resolution on Technical Transformation of Enterprises," Beijing Xinhua, February 3, 1982.

<sup>113</sup> See "Regulations on the Tentative System of Enterprise Funds for State Enterprises," Xinhua, December 19, 1978; and "Provisional Regulations Approved by the State Council on Strengthening the Work of Tapping Potential, Renovation and Transformation of Existing Industrial and Transport Enterprises," June 21, 1980, in Almanac of



was expected to force enterprises to innovate and upgrade their equipment and technology, instead of just building more factories as in the past. In other words, the reforms were supposed to encourage firms to expand reproduction by intensive (nei han) rather than extensive means.

Yet three years after the introduction of the reforms, there seemed to be little if any change in either the traditional bias toward investment in new construction nor the resistance to technical renovation.<sup>114</sup> In mid-

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China's Economy 1981, pp. 214-17.

<sup>114</sup> An article in the Hebei Ribao of February 8, 1981, lamented that still today, "Whenever we talk about increasing production, we stretch out our hands to the state requesting this and that rather than making serious efforts to tap the internal potentials of the enterprises themselves. Some localities and enterprises have unrealistically pursued high targets and great speed and requested money and materials from the state authorities. They have vied with one another in launching new projects and developing capital construction and ignored tapping the potentials of and initiating technical innovation and reform in the enterprises and overlooked the enhancing of economic results. In the minds of some people, only high targets and great speed are desirable. It seems that they are in charge of expenditure; and if there are no expenditures, then they will have nothing to do. . . they have seized the money and materials which should be used for promoting production and maintenance, tapping potentials and initiating technical innovation and reform. As a result, the technology of enterprises has remained backward, the outmoded equipment has for a long time not been replaced and economic results have been adversely affected. (emphasis added). FBIS February 10, 1981, pp. R4-5.

1981, the economist Xue Muqiao noted that "although the slogan of building fewer new factories and carrying out more innovations and improvements in old ones had been raised for more than 10 years now, the machinery and equipment in many of factories are now obsolete, the buildings are cramped and dilapidated, and there is still no way of solving these problems."<sup>115</sup> Six months later, a Renmin ribao editorial complained that enterprises were still not investing depreciation funds and funds allocated for development of production in technical transformation:<sup>116</sup>

At present, most of the enterprises are not making the proper use of these funds. A large part of the funds have been used for promoting capital construction projects and only a very small part has been used for carrying out technical transformation. The data obtained from investigations carried out in more than 60 enterprises in Beijing, Shandong, Jiangsu and other places show that only 20% of the depreciation fund set aside for the enterprises is used in renewal of equipment."

The failure to adopt new technologies could not be explained by the lack of their availability. The Deng

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<sup>115</sup> Renmin Ribao, June 2, 1981, p. 5, FBIS June 10, 1981, p. K10.

<sup>116</sup> "Technical transformation is a major policy," January 29, 1982, p. 1, FBIS February 5, 1982, p. K 7. (emphasis added).

leadership's call to "seek truth from facts" had set off a blizzard scientific research. Scientific research institutes proliferated ad infinitum -- and "quotas" for inventions were regularly overfulfilled. But evidently to no avail. In October 1982, Zhao Ziyang complained that instead of sharing information and new technology, "dozens of departments are doing identical research, an unnecessary repetition of basic procedures; while at the same time nobody is dealing with other problems that, if solved, could produce substantial results. Departments are heavily guarded against each other. It is said that some departments counteract each other's efforts and keep their achievements secret from each other."<sup>117</sup> Moreover, Zhao said, even when innovative technology was actually available, enterprises tended to see the adoption of new technologies as against their interests since it will most likely lead to increased demands by the state for greater output: "They are worried because they say, new technology brings them no benefit. Some even do not want to make an effort to develop new technology, cynically believing that

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<sup>117</sup> "A strategic question on invigorating the economy," speech to the National Science Awards Conference, October 24, 1982, in Beijing Review, November 15, 1982, p. 16.

more pressure will be put upon them."<sup>118</sup> Zhao then went on to cite several examples of how production units from pump factories to construction enterprises went out of their way to avoid introducing advanced technology, and concluded that<sup>119</sup>

Our current economic system is saddled with two fundamental drawbacks. One is that it cannot encourage enterprises to concern themselves with the needs of society and of the market and the inevitable result is the production is out of keeping with demand. The other is that it cannot capably encourage enterprises to care about technical progress. As a result 'the same old stuff is used over and over again for decades.'

In part, the failure of firms to use their resources for technical renovation can be explained by the fact that, despite the introduction of profit-retention, many individual enterprises still don't have sufficient capital for major upgrading or expansion -- because of the pattern of fragmented investment discussed above. But in my view, the most important reason for the system-wide failure of industry to regularly revolutionize production, is that despite the reforms, in reality, there is no real market pressure to compel firms to compete, therefore to force them to intensify production and to innovate to survive.

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<sup>118</sup> Ibid., p. 19.

<sup>119</sup> Ibid., p. 19. (emphasis added).

And without this objective pressure, the enterprises were free to avoid the difficulties of technical renovation with all its possible problems, and even, as we noted above, to divert their surpluses out of production altogether. It is to a discussion of this lack of market pressure that we must now turn.

#### II.E. From Subsidies to the "Natural Selection" of the Market?

In the last analysis, the success of the entire market socialist strategy hinged on one crucial assumption -- that decentralization would give rise to market competition. And market competition would discipline workers and managers alike to rationalize production along capitalist lines. As the reformer-economist Ma Hong wrote back in 1979:<sup>120</sup>

Competition launched among enterprises tends to encourage advances in production, improvements of product quality, increases in variety, reduction of cost, higher profits and greater contributions to the four modernizations. Competition enables better run enterprises and their workers to obtain more material benefits and poorly managed enterprises and workers to get fewer material benefits. The possible elimination through competition of poorly run enterprises which have incurred losses over a prolonged period will only benefit the state.

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<sup>120</sup> "Transform the economic management system, op. cit., p. 51.

Thus, the leadership sought to induce enterprise reform by means of a twosided strategy: on the one hand, economic incentives in the form of profit-sharing, and on the other, the threat of penalties up to and including bankruptcy if the firms don't shape up.

### **Firming up Soft Budgets?**

Parallel with the introduction of profit sharing in 1978-79, the reformers introduced a complicated series of changes in state-enterprise fiscal relations which were designed to compel the firms to discipline themselves, to conserve resources, and especially to restrain their excessive expenditures on investments and wages.<sup>121</sup> Through reforms in enterprise finance and taxation the leadership hoped to break the old pattern whereby the government invariably covered the losses of the firms, regardless of cause, a practice that encouraged tremendous waste of resources -- the classic pattern that Hungarian

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<sup>121</sup> Very good summaries of these reforms can be found in Barry Naughton, "False starts and second wind: financial reforms in China's industrial system," in Perry and Wong, eds., The Political Economy of Reform in Post-Mao China, pp. 224-52; *idem.*, "Finance and planning reforms in industry," in J.E.C., China's Economy Looks Toward the Year 2000, vol. I, pp. 604-29; Dean Carver, "China's experiment with fiscal and monetary policy," *ibid.*, pp. 110-31; and Andrew G. Walder, "The informal dimension of enterprise financial reform," in *ibid.*, pp. 630-45.

economist Janos Kornai dubbed the "soft budget constraint."<sup>122</sup> First, starting in 1979, the government began to replace the system whereby enterprise investments in renovation and expansion were funded by "costless" direct government grants, and instead made the enterprises apply to state banks for loans to cover these costs. The idea was that since the firms would have to pay these loans back, and at interest, managers would likely exercise more caution in planning investments. Correlatively, it was thought that since the banks were nominally autonomous and independent of the enterprises, and moreover, had their own profit picture to look out for, they would therefore tend to scrutinize the firms' loan applications with a view to the likely economic results of the proposed projects. Secondly, starting in 1979-80 and greatly expanded from 1983, the reformers introduced a series of new taxes designed both to impose costs on excessive consumption of factors of production, and also to help the enterprises compete on a more even basis. The government imposed new taxes on the use of fixed capital and on excessive expenditures on bonuses. Here again, it was

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<sup>122</sup> Janos Kornai, " 'Hard' and 'soft' budget constraint," Acta Oeconomica vol. 25, nos. 3-4 (1980), pp. 231-46; and "The soft budget constraint," Kyklos, vol. 39 (1986), pp. 3-30.

hoped that the threat of financial penalties would encourage industrial managers and their supervising agencies to economize on the use of fixed and circulating capital. Finally, in an effort to compensate for the inability of firms to compete on an equal footing given unequal technology, unequal access to resources, transportation and markets, and unequal costs imposed by the still unreformed price system, the government tried to equalize the burden of taxation on firms by introducing an "adjustment tax" (tiaojie shui).

#### **Still "Eating Out of One Big Pot"**

But here once again, the reforms failed to produce the intended effects. In the first place, the reformers' assumption that state banks could hold state firms accountable proved to be illusory. In practice, if the state wished to have its firms fulfill state-planned production, it had little choice but to "lend" them the necessary funds to carry on production. So the result was that, as one analyst observed, "banks are forced to lend to almost every enterprise that demonstrates a need for funds to meet planned production." Moreover, "branch banks -- bowing to pressure from local authorities -- still tend to supply credit according to enterprise needs, even when



those needs exceed plan."<sup>123</sup> Even high interest rates, imposed on borrowing for extrabudgetary investment, exercised little or no restraint on borrowing, because the state permitted the firms pay back the loans out of before-tax profits, in effect letting them pass the costs along to the state.<sup>124</sup>

The reformers' various schemes to tax excessive expenditures on capital construction and bonuses likewise came to naught. After some initial forays, by 1984 the government apparently gave up efforts to enforce the capital use tax.<sup>125</sup> But even where such punitive taxes supposedly remain in force, formally hard financial constraints have been routinely softened to insure that firms continue to carry on production. So even when firms do pay the fines, the burden of reduced profitability can usually be passed on to the government by means of reduced profit remittances.<sup>126</sup> Firms can be exempted from tax penalties,

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<sup>123</sup> Carver, op. cit., p. 127.

<sup>124</sup> Tidrick and Chen, eds., China's Industrial Reform, pp. 90-1, 268; Carver, op. cit., p. 127-8.

<sup>125</sup> Naughton, "Finance and planning reforms," op. cit., pp. 612-13.

<sup>126</sup> Tidrick and Chen, eds., China's Industrial Reform, p. 269. For some examples of government backsliding on the costing of capital, see ibid., p. 91. The government has also sought to impose fines for industrial pollution. But these, too, appear to fall mainly on the government, not the enterprises. According to one report, 80% of pollution

or they can be permitted to temporarily raise sales prices to recoup the losses incurred by taxes, or interest rates can be adjusted to meet the needs of the firms, and so on. Of course the result has been, as World Bank economist William Byrd remarked: "enterprises have no incentive to economize on their use of capital, and their latent demand for investment is restrained only by the availability of funds."<sup>127</sup> This softening of budget constraints is possible because, in reality, the enterprises, the banks, the tax offices are not independent and autonomous entities, as market socialists assumed or pretended (on the model of capitalist economies), but are organically tied to one another through the nexus of common state ownership. In his interview-based study of Chinese (many of them Shanghai) industrial executives and tax officials, UCLA industrial sociologist Andrew G. Walder gives us an extremely illuminating vignette of the close, even intimate, relations between industrial directors, their supervisors, and tax and banking officials. Walder notes that at the Shang-

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fees levied on the enterprises are returned to the polluting enterprises, earmarked for use in pollution control projects. See William Byrd, The Shenyang Smelter, p. 45.

<sup>127</sup> Tidrick and Chen, eds., China's Industrial Reform, p. 268.

hai Machine Tools Factory, for example, the government tax official has his own desk at the enterprise headquarters, and spends most of his time there. The bank, which is supposed to enforce firm accountability, often knows before the enterprise does when it will run into financial problems, and takes the initiative to offer the firm a loan, or reschedule an outstanding one. And so on.<sup>128</sup> Walder points out that major plant decisions with regard to expansion and construction, product changes, imports of equipment and so forth, are normally not made by the enterprise director alone, but by a working group comprised of the factory's chief executives, officials from the enterprise's "leading organ" (e.g. the municipal or country industrial bureau), and the responsible officials from the local finance and taxation bureaux. This same group also has the power to grant some tax exemptions, to revise pricing, and to forgive loans. Since this informal managing team share a common interest in the financial success of their enterprise, they, not unnaturally, see nothing wrong in bending the rules to ensure the firm's viability and success. After all, factories often run into financial trouble through no fault of their own, typically because of "objective conditions" such as irregular sup-

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<sup>128</sup> Walder, "The informal dimension," op. cit., p. 642.

plies and irrational pricing which are "beyond their control." So this local managing team naturally comes to see its own role, its mission, as that of helping the enterprise overcome these hurdles and succeed and prosper despite objective conditions, even if this means colluding to subvert the "hard budget constraint" the reformers at the top wish to impose. As the interviewees told Walder, despite their formally distinct offices, "we're all in this together." And, as Walder rightly adds, there is much truth to this:<sup>129</sup>

Are they not all working for the same side? Is it not all state funds anyway? Aren't executives seeking lower taxes not for personal gain but for the purposes of increasing production and serving the four modernizations? These in fact are precisely the attitudes that foster a soft budgetary regime.

Furthermore, this same attitude prevails at the national level -- and for the same reasons. Again, given existing irrationalities in pricing, the inability of suppliers to to guarantee regular and/or on-time deliveries of inputs, and so on and so forth, it is exceedingly difficult for the leadership in Beijing to determine when or to what extent enterprise financial difficulties are due to subjective factors such as poor planning or management

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<sup>129</sup> Ibid., p. 643.

or to "objective conditions." Partly for this reason (and partly for other reasons which will be explored in chapter five), despite their rhetoric of economic discipline, in practice the reformers have been extremely reluctant to penalize any state firms. Instead of letting actual profitability determine success or failure, the reformers have continued the past practice of basically guaranteeing each and every firm a "fair rate of profit," i.e. costs plus some reasonable profit.<sup>130</sup> Thus the center has reinforced the tendency to soften nominally hard budgetary constraints, and an important vehicle for these subsidies has been precisely the "adjustment tax." This tax, which was supposed to even out profit differences due to objective conditions, has in practice been used to confiscate the profits of efficient firms (in some cases taking away earnings due to superior management) and redistribute them to subsidize the inefficient firms. In fact, Beijing has consistently tended to tax the most profitable enterprises the heaviest -- irrespective of whether these higher profits were attributable to efficient management or simply windfalls accruing from exceptionally favorable objective

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<sup>130</sup> Ibid., p. 640.

conditions.<sup>131</sup> Either way, such practices inevitably tended to erase the distinction between efficient and inefficient firms, leveled out profits, destroyed the motivation to maximize profits, and thus subverted the reformers own reform goals.

Given the reluctance of the leadership to enforce the strict accountability they themselves advocated, it is hardly surprising that there is still no correlation between performance and profitability in Chinese industry. The World Bank/CASS study of 20 firms found "no systematic differences in the profit rate" between efficient (i.e. in its terms, market oriented) and inefficient firms, and added that "Perhaps more important than the lack of any systematic relationship between market conditions and profitability is the apparent failure of profitability to have an influence on enterprise response, at least in the

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<sup>131</sup> Walder, ibid., p. 640. Carver, op. cit., pp. 123-4. The central government has been especially concerned to recapture these profits since the onset of the fiscal crisis of the early 1980s. Another means of doing this was the (involuntary) sale of government bonds to enterprises, a practice from the early 1950s, which was resumed in 1981. This enabled the state, for a while at least, to siphon off funds from the enterprises to cover its growing deficits without resort to inflationary printing of money. See again, Carver, op. cit., p. 122.

short run."<sup>132</sup> The CESRRI analysis of 308 firms actually found an inverse correlation between productivity and profitability: "the enterprises with the highest rates of profit increase could only point to a middling rate of increase in labor productivity while enterprises with the most rapid increase in labor productivity had a rate of increase [in] profit averaging almost zero."<sup>133</sup> In sum, despite their intentions to the contrary, the reform leadership have continued the old policy of redistributing surpluses between firms, leveling out profits, just as the firm managers themselves have continued to distribute wages on an egalitarian basis, leveling out incomes.

**The Immortality of the Firm:  
"Responsible for Profits but Not for Losses"**

What then of the reformers "threat" to impose bankruptcy on the non-performers? As far back as June 1979, then Premier Hua Guofeng firmly insisted that:<sup>134</sup>

Badly managed enterprises which have shown deficits over a long period should reverse the situation and turn from deficits to profit within a year or must stop operation and undergo a shake-up; they will get

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<sup>132</sup> Tidrick and Chen, eds., China's Industrial Reform, p. 251.

<sup>133</sup> Reynolds, ed., Reform in China, pp. 100-101.

<sup>134</sup> "Report on the work of government," June 18, 1979, in op. cit., p. 32.

no subsidies from the government or credits from the bank.

This position has been reiterated time and again since then by Hua's successor Zhao Ziyang, and by China's leading economists.<sup>135</sup> But there have been no bankruptcies.<sup>136</sup> And instead of diminishing, subsidies to unprofitable industries have swelled since the introduction of the reforms. Nevertheless, they are not permitted to fail. In 1985, six years after the introduction of industrial reforms, the press still complained that:<sup>137</sup>

For some time, 20 to 30 per cent of China's State-owned industrial enterprises have been running at a loss every year. Losses of some factories have been several times bigger than their fixed assets and they are no longer able to repay their debts. In 1983, the total losses of State enterprises were equal to 18% of the nation's revenue. . . The State has for a long time been protective of these enterprises. No matter

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<sup>135</sup> Thus Zhao, speaking to the First Session of the Sixth NPC on June 6, 1983: "All enterprises that run at a loss due to poor operation must reverse this trend within a given time limit. Otherwise, they must be ordered to shut down, suspend operations, amalgamate with others or switch to the manufacture of other products." See his "Report on the work of government," in op. cit., p. 32.

<sup>136</sup> More precisely, there has been one reported and highly publicized recent example -- although, for reasons which will become apparent, this case does not really qualify under any conventional definition of the term. See chapter 5 section III.A.1 for an extended discussion of this case and analysis of the entire problem in the Chinese context.

<sup>137</sup> "Bankruptcy law needed for loss-making firms," China Daily, January 7, 1985.



how poorly they operate and how little profit they make, the State will try every possible way to keep them from closing down. Some factories are already practically bankrupt by the continue to survive on State subsidies. Although many enterprises produce nothing useful for society and their products make no profit, they still take their share of the State's 'big pot.' Managers or directors in these enterprises face no penalty for their poor performance, and the workers do not have to worry about losing their jobs.

And in 1987, the CESSRI analysts concluded that: "At present, enterprises are still not really wholly responsible for their profits and losses . . ."<sup>138</sup>

Investment decision-makers are in the envious position of engaging in profit-seeking adventures and being credited with success in operation without having any qualms about investment losses rebounding on themselves. The factory directors are not afraid of bankruptcy and workers do not fear unemployment -- this is what fuels investment expansion.

Chongqing Clock and Watch Company and Qingdao Forging Machinery Plant are two cases in point. These two plants, and Chongqing Clock especially, have been generally held up as models of advanced reformed enterprises because of the degree of their management autonomy, financial self-responsibility, and orientation to the market. So in theory at least, they should have been more subject to the pressures as well as the incentives of the market. In practice both firms were quick to seize the initiative in the context of expanding market opportunities in the years

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<sup>138</sup> Reynolds, ed., Reform in China, p. 13.

1979-81 to rake in more profits by increasing output. But when market conditions turned against them in 1982-83 (Chongqing Clock because of overproduction, Qingdao Machinery because of government cutbacks in heavy industrial growth starting from 1981), both firms, with the cooperation of their superior authorities, bent the rules to alleviate the threat to their financial solvency and preserve the "success" of the reformed enterprise. Targets were readjusted, prices were altered to insure profitability, loans were changed to grants, taxes exemptions were freely granted -- and meanwhile both firms failed to reduce costs and continued to overspend on bonuses and collective welfare despite falling profits.<sup>139</sup> Thus, World Bank economists Byrd and Tidrick concluded that<sup>140</sup>

All in all, there is abundant evidence that in China the enterprise budget constraint remains "soft," despite the fact that the market constraint has become rather tight for many firms. No matter what the circumstances, it is virtually inconceivable that the Chinese government would allow enterprises like CCWC and OFMP to go bankrupt. China and Yugoslavia may be the only socialist countries where many firms may be characterized simultaneously by a soft budget and a "hard" market constraint.

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<sup>139</sup> Byrd et. al., eds., Recent Chinese Economic Reforms, pp. 47-9, 61-3, and 86-8.

<sup>140</sup> Op. cit., p. 62. (emphasis added).

In a context in which "almost every enterprise on one pretext or another is made into an exceptional case," Byrd and Tidrick naturally wonder about the replicability of these reforms throughout the economy: "If reforms worked only because of special treatment, they cannot be expected to work when applied on a larger scale, for it is impossible to provide preferential treatment for every firm."<sup>141</sup>

### **Breaking the "Iron Ricebowl"?**

Yet, according to China's market socialist theorists, even if enterprises were permitted to fail, this would be essentially painless to the firms' employees. Indeed, this is said to be one of the advantages of socialism over capitalism. Thus Ma Hong continues from the quotation cited above: "As regards the workers employed by these enterprises, they will get other jobs from the state without fear of unemployment as a result of the elimination of their employers, the latter being the case in capitalist countries."<sup>142</sup> And indeed it appears that the

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<sup>141</sup> Byrd et. al., eds., Recent Chinese Economic Reforms, pp. 48 & 61.

<sup>142</sup> Likewise, the reformer-economist, Xue Muqiao: "By ensuring competition, various trades and enterprises will be forced to reform and reorganize. Otherwise, some enterprises will be eliminated through competition. Then the question arises as to whether a large number of medium-sized and small enterprises will go bankrupt. I think this can be avoided by encouraging integration." Beijing Review, September 8, 1980 p. 22.

reformers themselves have enforced this policy over the past decade. As the authors of the CESSRI study note:<sup>143</sup>

In China today, if a factory closes down, all its people, from the director down to the workers, will continue to draw the same pay as usual from the factory, and all of them will be transferred to other enterprises by departments concerned. Such a "close-down" will not impose a true penalty on the bankrupt factory. No one will be held responsible for the bankruptcy.

Rather, the punishment will fall on society at large or on other enterprises.

This is typical of the reformers efforts to get the best without the worst of the market. But of course the problem is that, if there is no "fear" of bankruptcy or unemployment there is no discipline of the market to compel the enterprises and their employees to perform efficiently. This being the case, it remains a mystery precisely how the reformers expect competition to develop and enforce the hoped for capitalist economic rationality.

#### **Learn from Hungary?**

In short, China's experience of "market" reforms has more or less simply recapitulated the course of similar

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<sup>143</sup> Reynolds, ed., Reform in China, p. 157.

market reforms in East Europe. The economist Janos Kornai described Hungary's experience in these words:<sup>144</sup>

During the first ten years of the reform in the Hungarian economy practically no bankruptcy occurred: no firm operating with losses was fully liquidated. Workers are guaranteed not only employment, but even employment in their present job. Following the price explosion on the world market not a single Hungarian firm went bankrupt. Using the popular expression in Hungary: the state 'took over' the losses. The 'natural selection' entailed by economic competition did not take place: the strong and the weak, the active and the passive, the innovative and the incompetent all survived the storm.

The state can rescue the firm on the brink of ruin by various methods. It grants special subsidies; if the product in question has a fixed price, it allows a price increase out of turn; it grants tax exemption or duty concessions to the firm, the bank permits credit at favourable terms or allows postponement of repayment, etc.

### III. FROM REFORM TO READJUSTMENT AND BEYOND

The market socialist strategy was crucially premised on the assumption that lower-level cadres, in particular the enterprise directors, were better placed to know the needs of consumers as well as the potentials of producers, and therefore better positioned to take charge of rationalizing the economy. Yet as we've seen, these cadres regularly and systematically violated the aims of the

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<sup>144</sup> "The dilemmas of a socialist economy: the Hungarian experience," Cambridge Journal of Economics no. 4 1980, p. 152. See also idem., Economics of Shortage (Amsterdam: North-Holland, 1980), chapter 13.

reformers at the top. Every time the state relaxed its grip on the managers, instead of cutting costs, improving efficiency and productivity, they looked for ways to boost output regardless of cost and "need," to maximize consumption at the expense of production, to maximize costs (i.e. inputs), to hike wages and equalize bonuses, to enforce self-sufficiency at the expense of specialization, and so on. This meant that almost from the very start of the reforms, the reformers faced a new conundrum: the problem of overdecentralization.

As early as the spring of 1979, barely a year after Hua Guofeng announced the first reforms, it was already becoming apparent that the industrial and state fiscal/administrative reforms were far from producing the sort of economic rationality originally envisioned. Overexpansion of capital construction and overproduction in industry, especially in heavy industry, were throwing the economy further out of balance. The bureaucracy's spending spree and overissuance of bonuses, combined with falling productivity and falling state revenues plunged the national budget into the red resulting in a deficit of Y6-7 billion for 1978 -- China's first reported deficit.<sup>145</sup>

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<sup>145</sup> The government originally reported slight surplus of Y1 billion for 1978. (See Zhang Jingfu, "Report on the final state accounts for 1978 and the draft budget for 1979," delivered on June 21, 1979, in Main Documents of the Second Session of the Fifth National People's Congress of the People's Republic of China, (Beijing: Foreign Language Press), p. 149). However, in 1981, a report

With the economy spiraling out of control, with "economic levers" seemingly unable to enforce rational economic decisionmaking, faced with persistent problems of waste and inefficiency and an unprecedented wave of economic crime, the reformers saw little choice but to call a halt to the reform drive and recentralize much of the economy. The leadership conceded that it had "lost control" over capital construction as well as budget expenditures, imports, prices and wages.<sup>146</sup> In a self-criticism before the Central Committee in mid-March 1979, Deng reportedly blamed himself for the "disaster." As a consequence of decentralization, Deng is said to have remarked that now "a little section chief is in the position of signing contracts worth tens of millions of U.S. dollars, to the

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attributed to Zhao Ziyang stated that the country's deficits between 1978 and 1980 averaged 10% of expenditures. This suggests an actual deficit of about Y6-7 billion. This seems to be corroborated by subsequent reports of construction expenditures that year which showed figures nearly Y3 billion higher than the original official figures. See Martin Weil, "Readjustment phase II," The China Business Review, (July-August 1981), p. 18.

<sup>146</sup> See Xue Muqiao's comprehensive review of the errors of reform since 1978 in his "Tiaozheng guomin jingji gao hao zonghe pingheng" (Readjust the national economy and strike an overall balance) Jingji Yanjiu no. 2, 1981, pp. 25-31. Also see Ma Hong, New Strategy, pp. 77-78; and Robert Dernberger, "Search for the path of self-sustained growth," in Under the Four Modernizations, p. 32.

extreme embarrassment of the central government. If we don't approve these contracts, we shall lose face. If we do [words indistinct] can we find the money. . . we must put a brake [on these practices], the face problem can wait."<sup>147</sup> In February 1979 the government froze US\$3 billion in contracts with Japan, including \$1 billion down on the giant Baoshan steelworks. In March, a National Capital Construction conference postponed many of the 120 key projects announced the year before. In June, at the Fifth National People's Congress, Hua Guofeng himself, scrapped the 1976-85 Ten-Year Plan he had put forward to the previous session of the Congress in March 1978. Retracting the grandiose goals of the original plan, Hua announced the leadership's new policy calling for "three years of readjustment, reform, consolidation and improvement" -- the so-called "eight characters" policy (tiaozheng, gaige, zhengdun, tigao).<sup>148</sup>

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<sup>147</sup> Agence France-Press, June 15, 1979 quoting from a Taipei intelligence report. JPRS No. 73862 July 19, 1979, pp. 6-7.

<sup>148</sup> See Hua's "Report on the work of government," in Main Documents of the Second Session of the Fifth National People's Congress of the People's Republic of China, (Beijing: Foreign Language Press, 1979), pp. 5-100.



### III.A. From Pragmatism to Confusion

Readjustment requires temporary strengthening of the central authorities' centralized, unified management of the economy, whereas reforms call for decentralization of power. In order to solve this contradiction, it is necessary to persist in making reforms while readjusting the national economy and in readjusting the national economy while making reforms.

Renmin Ribao, November 6, 1980

The leadership's new approach, presented in Hua's programatic document, aimed to pursue two directly counterposed strategies, simultaneously. The new policy called for the recentralization of economic decision-making authority to bring capital spending and the wage bill under control, to restore balance in the economy, to stabilize prices, as well as to curb corruption (these were "readjustment" and "consolidation"). At the same time, it called for continued reform, viz. decentralization, and in particular, stepped-up devolution of economic decision-making powers onto the enterprise directors and local authorities ("restructuring"). To be sure, Hua tried to set priorities: "readjustment, restructuring, consolidation and improvement are interrelated and mutually complimentary. But today it is readjustment that is crucial for the economy as a whole." Nevertheless, it would be difficult to conceive of a more explicitly self-contradictory policy. And it is this attempt to simultaneously pursue inconsistent aims and policies that

accounts for the equivocations and reversals of policy in China from 1978 to the present.

### Damage Control

In subsequent years, the Deng leadership has rewritten history to portray "readjustment" as if it were part and parcel of the original reform program. Thus the strategy of "reform and readjustment" was said to have been instituted with Deng's consolidation of power at the "historic Third Plenum" of the Central Committee in December 1978, and this interpretation has been generally followed in the West.<sup>149</sup> In reality, this chronological revision was a crude attempt to retroactively blame Hua for the calamitous results of the initial industrial and fiscal reforms, efface Deng's responsibility for these "mistakes," and credit Deng (and Zhao) with initiating the (correct) policy of readjustment. As such, this interpretation is defective in several respects. First, as noted, the Four Modernizations reform program was launched in February not December 1978, and if Deng and Zhao had any reservations about Hua's "impetuosity in seeking

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<sup>149</sup> See eg. Carl Riskin, China's Political Economy, pp. 284-5 and 311 note 1. Also see the Introduction to Modernizing China: Post-Mao Reform and Development (Boulder: Westview, 1986), A. Doak Barnett and Ralph N. Clough, eds.; and the Introduction to the China Quarterly no. 100 (December 1984), a special issue on the readjustment.

quick results" they voiced no opposition at the time, and in fact they raised no objections until the next year. Secondly, there is no mention of "readjustment" in any of the relevant documents of 1978, notably the "30 Point Decision on Industry (July 1978)," the "60 Articles on Agriculture" (December 1978) nor the "Communique of the Third Plenary Session of the Eleventh Central Committee of the CCP" (December 1978) -- and these documents explicitly support the "unrealistic" goals put forth by Hua in February 1978.<sup>150</sup> Indeed, the Communique not only explicitly "approved" Hua's plans "in principle" but reaffirmed that "these arrangements are forward looking and feasible."<sup>151</sup> Thirdly, the "turn" to readjustment was not officially proclaimed until June 1979 -- and then, as noted, by Hua Guofeng (although, as also noted, steps toward recentralization had already been taken earlier in the year).

My own interpretation is that the turn to readjustment -- which was necessitated by the appearance of unforeseen and unintended consequences growing out of the original reforms -- signaled the effective collapse not

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<sup>150</sup> For the full citations see chapter one, note 45.

<sup>151</sup> See the original text of the Communique, and translation, in op. cit.

just of Hua's original "unrealistic" targets, but of Deng Xiaoping's entire strategy of using decentralization and marketization to rationalize the industrial economy. Readjustment signaled the abandonment of whatever theoretical coherence the original market socialist strategy once had, and the elevation of a crude pragmatism to the level of strategy. True, the reform leadership has never abandoned market socialism as its goal. But in practice, since 1978 the leadership has careened from one policy extreme to the other, from reform to recentralization and back again, and in the process the reform drive has disintegrated into confusion, contradictory policies and ad hoc solutions to crises as they developed.

#### **Deng Xiaoping's "Second Revolution"**

By 1984, the industrial reform drive appeared to have reached an impasse. Whereas the agricultural reforms were (at that time) daily producing results beyond the dreams of even the most optimistic reformers, the industrial reform drive had stalled. Three years of readjustment followed by two more years of renewed (if rather tepid) reforms had failed to improve industrial performance. State-led retrenchments from 1979 only precipitated recession in 1981. The subsequent relaxation only sent the economy "out of control." In each year since 1982, investment set new records and output far outstripped the plans. Heavy industry continued to outpace light industry. Out-

of-plan production by lower-level officials starved the state's "key projects" of resources. Inefficiency, waste of resources, and mounting losses were the rule. As a result, by 1984, the consensus of Western analysts and, it seems, the self-assessment of the reformer-economists around Deng, was that the potential of reform was being thwarted by the government's continual "interference" in the economy and its reluctance to fully implement critical reforms, notably, price reform. The argument was that the agricultural performance had dramatically improved mainly because the government had take the radical step of more or less completely getting out of farm management. By contrast, the government had only introduced very partial reforms in the industrial sphere, and the recentralizations since 1979 only further delayed the potential benefits of industrial reform.<sup>152</sup>

This is the conception that lay behind the highly publicized announcements in the fall of 1984. In October 1984 a special session of the Communist Party Central Com-

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<sup>152</sup> For this perspective, see e.g. Susan L. Shirk and James B. Stepanek, "The problem of partial reform," in The China Business Review (November-December 1983), pp. 8-9; and Shirk's larger paper on which this piece is based, "The politics of industrial reform," in Perry and Wong, eds., The Political Economy of Reform in Post-Mao China, pp. 195-221. See also, Nina P. Halpern, "China's industrial reforms, the question of strategy," in Asian Survey, (October 1985), pp. 998-1012.

mittee (the Third Plenum of the 12th Central Committee) announced with great fanfare that it had determined to launch a sweeping overhaul of the urban-industrial economy. In a pledge to "carry its successes in the rural economy over into the cities" the Party's "Decision on economic reform" announced a large-scale restructuring of the urban economy.<sup>153</sup> The Decision stated that henceforth, market forces and material incentives would be given a powerful determining role in the economy. Wages and bonuses would be linked to job performance. Enterprise management would be more rigorously separated from political control so as to make the firms "more truly independent economic units." The number of industrial product categories subject to central planning would be cut from 120 to 60, and farm product groups from 29 to 10. Serious price reform, at long last, was definitely scheduled for "early next year (1985)." Restrictions on foreign trade were to further relaxed. And so on.

It was more than a little disingenuous of the Deng leadership to imply that "urban reform" was somehow novel since it had been trying to implement precisely these

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<sup>153</sup> See the "Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure," adopted by the Twelfth Central Committee of the C.P.C. at its Third Plenary Session on October 20, 1984, FBIS October 22, 1984, pp. K1-19.

policies for the past six years -- without success. That the leadership felt compelled to announce such a big push was, in reality, a recognition that urban reform had, thus far failed. Nevertheless, the leadership's publicity offensive and show of unanimity behind the reforms gave rise to great expectations in the West. Such speculation was further fueled by the "breathtaking" (to recall New York Times columnist Flora Lewis's term) December 7 (1984) front page commentary in the People's Daily declaring that the works of Marx and Lenin could not be expected "to solve today's problems."<sup>154</sup> The Western business press naturally greeted such admissions with delight. But they, and many sinologists also, misread Deng's intentions to mean that market forces were to be given a dominant role in the economy.<sup>155</sup> Following the Central Committee meeting, in the fourth quarter of 1984, the government once again veered sharply toward decentralization. Bureaucratic controls were relaxed. Wage and credit restrictions were

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<sup>154</sup> Three days later, the paper retracted its "abandonment of Marx" with an editorial stating that the original commentary had been in error. The commentary should have said that Marx and Lenin's works could not "solve all of today's problems." Renmin Ribao, December 10, 1984.

<sup>155</sup> E.g. see the cover stories of Business Week for January 14, 1985: "Capitalism in China," and Fortune magazine for February 18, 1985: "Open for Business? China After Marx."

loosened up. Price controls were partially lifted. Central controls on foreign trade were again relaxed.

But, as might have been expected, this just led to another bureaucratic gold rush. Emboldened by the leadership's unanimity behind reform, the enterprise managers and lower level-officials launched into a free-for-all binge of spending, construction, consumption (and corruption). The enterprises were granted wide discretionary powers over prices, wages and investment. But once again, instead of using their newfound powers to rationalize the economy, what actually happened, as Zhao Ziyang subsequently complained, was that many organizations and individuals abused them to justify their pursuit of their own units' interests at the expense of the state and the people, and pursue immediate interests at the expense of the long-term interests of the development of production."<sup>156</sup> Enterprises and administrative units "proceeding from their own narrow interests, indiscriminantly raised wages and handed out bonuses and allowances in order to

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<sup>156</sup> Zhao Ziyang, "The current economic situation and the reform of the economic structure -- report on the work of government," delivered on March 27, 1985 at the Third Session of the Sixth National People's Congress, Beijing Review, April 22, 1985, p. XIII.



increase the base figures for wages."<sup>157</sup> Payrolls for staff and workers in 1984 shot up by 19% over 1983, 38% in the last three months of the year. To finance this salary bonanza the enterprises borrowed from the banks. And the banks, Zhao said, "vied [with one another] in granting loans."<sup>158</sup> Bank lending increased by 46% in the last three months of 1984. Overissuance of currency spurred inflation to 12% in 1985, the highest rate since the revolution. In just the two months of November and December 1984, China's carefully built-up surplus of foreign exchange dropped from US\$16.7 billion to \$14.4 billion. By June 1985 it dropped to \$11.6 billion.<sup>159</sup> The leadership also complained that a "new evil wind" of corruption seized the bureaucracy with officials setting up dummy companies to trade in state property, engaging in illegal foreign currency dealings, and taking kickbacks for handing out jobs, promotions and unearned wage increases.

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<sup>157</sup> Ibid. p. VII.

<sup>158</sup> Ibid.

<sup>159</sup> New York Times, November 27, 1985 citing International Monetary Fund statistics. The Asian Wall Street Journal of January 6, 1986 reported that reserves dropped as low as \$10.9 billion during 1985, before the government intervened to arrest the the fall.

**From the "Two Expansions" to the  
One Recentralization: the End of the Capitalist Road**

With investment, wages, credit and production and corruption once again racing "out of control" in Zhao's words, the central government's response was not long in coming. In March 1985, Number One capitalist roader Deng Xiaoping called for a general attack on "capitalist thinking" and reminded his comrades that "the ultimate goal is to implement communism." Whereas in October 1984 Deng had reassured the Party that "a little capitalism was harmless," in March 1985, the veteran pragmatist told the Party that "There are people who fear that China could become capitalist. This fear is not without foundation. We must address their concern with deeds, not just empty talk." And he did. In the same month the government clamped down hard and reimposed tight curbs on wages, credit and prices, and sharply reined in spending to slow the rate of growth. The government once again deferred or cancelled thousands of foreign trade deals. It also moved to reassert control over foreign trade, revoking the import licenses of domestic trading corporations, and replaced the leadership of the Bank of China to stop indiscriminate loans. In the summer and fall of 1985, after the revelations of the scandals surrounding the corruption in foreign trade and the Special Economic Zones, the government intervened to curb free market activities

in the SEZs and retracted its original proposal to open up fourteen more coastal cities.

"Once centralized, rigidity sets in.  
Once decentralized, chaos ensues."

--Hu Qizomu, Peking Review, November 17, 1978

This recentralization, like those before it, was rationalized as a temporary expedient, a "necessary administrative intervention." Thus, reflecting the trepidation of the radical reformers at the top, the CESRRI analysts conclude in their summary report that:<sup>160</sup>

The macro imbalance that confronts us is severe indeed. Until we are able to curb the "two expansions" (expansion of consumption and expansion of investment), some remedial measures are unavoidable. For the sake of preserving reform, this recentralization must be carried out resolutely. With so many problems arising from our microeconomic mechanisms, rashly to change mandatory administrative control into indirect economic regulation at the macro level would run the risk of "one move amiss, the whole game a mess."

The recentralization of 1985-86 resolved nothing of course, and so restraints were lifted once more in 1987. This only produced the inevitable "mess" again, with investments and inflation soaring to new heights -- thus calling forth the inevitable recentralization in mid-1988. But while such recentralizations may momentarily retrieve scarce investment funds from the grasp of self-interested lower-level cadres, they only revived again all

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<sup>160</sup> Reynolds, ed., Reform in China, p. 19.

the the original problems of overcentralization, and so could scarcely pose a long-term solution. Hu Qiaomu stated the dilemma very succinctly. Neither strategy offers a solution.

**Conclusion:  
Neither Market Nor Socialism**

In sum, after a decade of reform in China, virtually all the underlying problems that have plagued the industrial economy since the 1950s -- weakening productivity despite ever growing investments, lack of connection between performance and reward, bureaucratic mismanagement and poor labor discipline, resistance to innovation, overinvestment and overproduction, departmentalism and localism -- remain unresolved. Indeed, in some respects many of these are worse than ever. Meanwhile Deng's reforms have piled new problems onto old in the shape of runaway out-of-plan investment and production, a vast expansion of subsidies, large budget deficits, double-digit inflation, and a mounting indebtedness to foreign bankers. In the end, instead of getting the best of both worlds, as the reformers hoped for back in 1978, they got the worst of both worlds -- neither competition induced efficiency, nor rational planning.

## CHAPTER 4

### BETWEEN THE MARKET AND THE PLAN: DECENTRALIZATION AND BUREAUCRATIC CORRUPTION

The political degeneration, loss of revolutionary discipline, and corruption of the party cadre-bureaucracy had been a steadily growing problem since the early nineteen-fifties. In 1957 Mao himself complained of the cadres that: "They vie with each other not in plain living, doing more work and having fewer comforts, but for luxuries, rank and status...they scramble for fame and fortune and are interested only in personal gain." And again in the early 1960s Mao remarked that "their work is in a state of chaos . . . they are divorced from reality, from the masses, and from the leadership of the party. . . Their revolutionary will is weak; their politics has degenerated . . ."<sup>1</sup> Mao sought to arrest this degeneration through the Cultural Revolution, but with the collapse of this

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<sup>1</sup> Quoted in my "China and the crisis of maoism," part 1, pp. 55-56.

strategy, the failure of the Cultural Revolution, cadre indiscipline and lawlessness became rampant.<sup>2</sup>

If these tendencies remained unresolved under Mao, Deng Xiaoping's economic reforms drastically worsened the problem -- indeed there much truth in the charge by Deng's critics that the reforms are in large measure responsible for the orgy of corruption that has engulfed every level of the party-army-bureaucracy since 1978. With decentralization, firms and local government units organized systematic exploitation of the state and the consumers on a vast scale. As a 1985 editorial put it:<sup>3</sup>

In the past, those who sought to advance personal interests by abusing power were individuals, but the present unhealthy tendencies are pursued in the name of organizations. In the past, people engaging in such malpractices carried out their activities through establishing secret back-door dealing, but now they take advantage of the loopholes in the current economic reforms to seek personal gains under the banner of reform and upset the unified arrangements of the State Council under the pretext of expanding decision-making powers, and infringe upon the overall interests of the state in the name of working for the interests of the staff and workers of their specific units. They pursue the malpractices in

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<sup>2</sup> See again the reportage of Liu Binyan, notably his "People or Monsters" and "Warning," and the short stories of Bai Hua, especially "A Bundle of Letters," translated in Perry Link's Stubborn Weeds (1983) and People or Monsters? (1983). See bibliography.

<sup>3</sup> "Correcting the new unhealthy tendencies is an urgent task at present," Jingji Ribao, March 14, 1985, pp. 1,3, FBIS March 20, 1985, p. K17.

the name of invigorating the economy, but, in fact, they have reduced the economy to chaos and benefit themselves and their circles at public expense.

In the first place, Deng's economic reforms actually left the cadres, especially the lower-level officials and industrial managers, little choice but to resort to illegal actions. This was because, as the cadres have argued in their own defense, in the context of a part-market-part-bureaucratic system corruption has been unavoidable, indeed necessary and essential to maintain production. Under the previous centrally planned system of materials allocation, supplies were taught and distribution relatively inflexible. And since planned allocations were often insufficient, not to specification, or not in time, production units had long ago been forced to devise a system of informal supply, that is, a black market to cope with the rigidities of the centralized supply system. Every production unit, every factory employed a staff of cai gou yuan, literally, "purchasing agents" or "buyers" but better understood as "fixers"--the equivalent of the Soviet tolkachi, to help them procure what they needed but couldn't get from the plan "through the back door"--in return for bribes and favors.<sup>4</sup> Many production units

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<sup>4</sup> In his description of this phenomenon, Fox Butterfield cites a letter to the People's Daily from a county in Jiangxi province which disclosed that "communes in the area had to buy 60 to 70 percent of the chemical fertilizer through the back door since the amount of fertilizer allocated to them by the central plan fell far short of what they had to have for their crops. The communes

stockpiled goods for which they had no need, as "hard currency" (yingtong huo) for barter to obtain needed supplies.<sup>5</sup> Though technically illegal, resort to this second economy had long been routine.

The reforms, some imagined, would overwhelm this black market with a legal free market thus rendering commerce more visible and rational.<sup>6</sup> But in fact, instead of

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actually signed private contracts with the fertilizer factories, the letter writer charged, paying the plants with their produce: pork, peanuts, soybeans, melon seeds, or timber." To conclude such deals, he added, "the commune officials also had to treat factory cadres and their drivers to banquets and ply them with liquor and cigarettes." China: Alive in the Bitter Sea, (New York: Bantam Books 1983), pp. 96-97.

<sup>5</sup> Xue Mugiao, "Guanyu jingji tizhi gaige wenti de tantao" (An inquiry into problems of reforming the economic system), Jingji Yanjiu no. 6, June 1980, p. 11.

<sup>6</sup> Thus an editorial in Caimao Zhanxian Bao stated that one of the major reasons for the "popular practice" of paying off middlemen "is that there are too many barriers in the channel of commodity circulation. Therefore to solve this problem, it is necessary to pay attention to the application of economic methods, adopt economic means, develop a diversified economy and open up various channels in order to enliven commodity circulation . . . thereby eliminating profit-making intermediaries. There is much work to be done by commercial departments in rural and urban areas in this regard, such as setting up trade center, exchanges and trust stores in order to help commodity procurement and marketing and stepping up efforts to improve services for both purchasing and marketing units. Moreover, it is necessary to utilize newspapers and mass media to carry more commercial advertisements on commodity supply and demand so as to promote direct contacts and trade among all circles." (Emphasis added). "Resolutely stop the undercurrent in commodity circulation," Xinhua, November 25, 1980, FBIS November 26, 1980, p. L30-31.



diminishing, the system vastly expanded after 1978. The expansion of the system was caused in part by reforms which substituted "guidance planning" (i.e. recommended output targets) for mandatory output targets, and which reduced the scope of centralized materials supply. With flexible output quotas, firms have been under less compulsion to fulfill specific targets. But by the same token, without rigid output targets, downstream firms could not be assured of regular supplies, and so they have been driven all the more into extra-legal dealings. The inevitable result was that, to maintain production, firms were driven to conceal and withhold part of their output, even some intended for state distribution, to sell or barter in exchange for needed inputs.<sup>7</sup> The government complained that by 1982, only 53% of steel products, 24% of cement and 51% of coal was distributed by the state as compared with 95%, 71% and 75% respectively, in 1965. As a result, the government said, "the state has found it difficult to plan the distribution of supplies. More serious

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<sup>7</sup> See eg. "It is imperative to stop certain localities and enterprises from withholding and disposing of supplies intended for unified state distribution," Xinhua, July 20, 1983, FBIS July 22, 1983, pp. K21-22.

still, the state's key construction projects have been hampered, and economic malpractices, profiteering and speculation in supplies and other irregularities have increased since the bulk of supplies that have been withheld are sold for projects not included in state or local government plans."<sup>8</sup>

Furthermore, reforms which granted the enterprises the freedom to market over-quota production, and, almost as important, permission once the quotas were filled, to shift into other lines of production, to produce products not assigned by the plan, gave enterprises tremendous incentives to expand out-of-plan production (because they could keep the profits), for which by definition materials were not allocated. Here again, the leadership's call to "boost profits" drove the enterprises further into illegal dealings.

By mid-1981, Central Committee Discipline Inspection Commission circulars reported that "bribery, blackmail and graft and extortion" had reached unprecedented levels.<sup>9</sup> Those in control of scarce goods demanded favors without

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<sup>8</sup> Ibid. p. K22.

<sup>9</sup> Eg. see the "Circular on enforcing party discipline, and eliminating the unhealthy practice of under-the-table relationships," issued July 20, 1981, and published by Xinhua, August 6, 1981, FBIS August 7, 1981, pp. K1-3.

which they "would make things difficult" thus slowing or halting production. "This has "caused state funds amounting to hundreds of millions of yuan to flow into the hands of small collectives and individuals through hundreds of thousands of loopholes, thus seriously undermining socialist economic construction."<sup>10</sup> "Giving presents, offering bribes and going through the back door have become means for our enterprises to procure materials and market unsalable products."<sup>11</sup> One letter to the Commission from a purchasing agent of an arts and crafts plant in Jiashan county, Anhui province, protested that "nothing can get done without bribes." "Not only do we have to try the back door for commodities regulated through the market mechanism, but some planned materials appropriated by the state also cannot be obtained if we don't send presents and offer bribes."<sup>12</sup>

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<sup>10</sup> Ibid.

<sup>11</sup> Zheng Ming (Hong Kong) July 24, 1981 p. 1, FBIS July 28, 1981 pp. W3-4 citing extracts from letters written by party members to an internal organ of the CCP Discipline Inspection Commission.

<sup>12</sup> Ibid.

In July 1981, the State Council actually outlawed payments or commissions of any kind to cai gou yuan.<sup>13</sup> But subsequent Central Committee Discipline Inspection circulars testified to the futility of attempts to coax the cadres to obey the law. "No matter how loudly we call," one circular read, "some cadres in our party, primarily responsible cadres have actually turned a deaf ear to the call [to stop corruption]."<sup>14</sup> Another stated that one of the most important reasons bribery and corruption has not been stamped out "is that our relevant departments have not executed the existing laws or have not executed them

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<sup>13</sup> A July 15 circular of the State Council stated that "from now on, anyone who accepts or extorts commissions by making things difficult for end users will be dealt with for bribery and embezzling public money . . . Enterprises, economic departments and non-productive units are prohibited from issuing money to their purchasing and sales personnel for dinners or gifts to get things done." Some enterprises, the council noted, "resort to what amounts to bribery to get badly needed materials, sell products and conclude contracts. There have been cases in which so-called middlemen and purchasing and sales personnel have received money and/or gifts valued at several hundred to more than 10,000 yuan." In case the threat of legal action prove an insufficient deterrent, the council proposed to bolster this with "education in socialist business ethics," and said that "a clear line must be drawn between competition under socialism and competition under capitalism." [!!] Xinhua July 17, 1981.

<sup>14</sup> Central Discipline Inspection Commission Circular on extravagance and waste, Beijing Xinhua, December 29, 1979, JPRS no. 74974, January 22, 1980, p. 84.

strictly. Some of them are . . . apathetic in fighting against and punishing those who are involved in this evil practice, thus they objectively encourage [it]. Others acquiesce, support and even act in collusion and clear the way for a few lawless persons to swallow the fruits of the sweat and blood of the people like whales."<sup>15</sup>

**"Should cadres take the lead in getting rich?"<sup>16</sup>**

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<sup>15</sup> "Resolutely stamp out 'under-the-table' relationships," Renmin Ribao, August 7, 1981, p. 1, FBIS August 18, 1981 p. K5. (Emphasis added).

<sup>16</sup> This was the provocative question put to readers of the party's theoretical journal, Hongqi, in May 1983. Doubtless, many cadres were comforted to learn that what's good for the Four Modernizations is good for them. Speaking to rural grassroots level cadres, the journal allowed that: "The party constitution not only requires party members to 'execute the party's decisions perserveringly,' but also stipulates that party members have the duty to play an exemplary role in production. All party members serving in economic departments and on production fronts are duty-bound to make the greatest contributions to the state and the people through industrious labor. Rural party members must work hard to fulfill the party's program for agricultural development." Of course, the article continued, "If a party member takes the lead in doing physical labor and in developing production and becomes rich through hard work, it is also very natural. . . Of course [the Communist Party] will not object to its members trying to become rich through hard work."

Despite the obligatory caveat about getting rich through physical work [laodong], what with the party's urging the peasant's to go into trading and commerce, and the promotion of "joint stock companies" in rural enterprises, everyone understood that there were many legal and illegal ways to get rich -- physical work being the least of them. See Xue Yan, "Is it necessary for rural party members to take the lead in becoming rich through labor?" Hongqi, no. 9, May 1, 1983, pp. 46-47, JPRS no. 83822, July 6, 1983, pp. 80-3.

But more than direct economic pressures, Deng's relaxation of central controls opened hitherto undreamed of possibilities for the cadres to enrich themselves. In the first place, the expansion of trade with the west, the Open Door, spread before the cadres the prospect of a new world of consumption, and with it, unprecedented incentives and opportunities for corruption. At the same time, the leadership's own emulation of western bourgeois lifestyles and its promotion of economic egoism with the slogan "getting rich is glorious," gave the cadres the ideological go-ahead for self-enrichment.

#### **Smuggling and the "Fever of Going Abroad"**

If Deng's open door policy hasn't transformed domestic production it has certainly transformed domestic consumption. High technology has, for the most part, come to China in a flood of consumer goods. In February 1980, a Shanghai news broadcast reported that "With the increase in international exchanges, more people visited Shanghai last year. This gave lawless elements an opportunity to engage in smuggling."<sup>17</sup>

At the same time, the number of profiteers and brokers has also increased. In streets, alleys, tea houses, restaurants, parks, even in front of stores,

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<sup>17</sup> Shanghai City Service February 21, 1980, FBIS February 25, 1980, p. 03.

people have been seen peddling foreign goods and buying gold, musk, jewelry and jade pieces to be smuggled out of the country. . . Since the beginning of this year, major cases of smuggling and selling of smuggled goods have been discovered, involving principally TV sets, radio-recorders, electronic calculators and wristwatches.

By 1981 things had gotten so out of hand that the state that the State Council convened a work conference to crack down on the wave of smuggling. Gu Mu, the state councillor most directly responsible for the opening, reported that "since last year, smuggling activities have run rampant in the coastal areas of Guangdong, Fujian and Zhejiang and involved many other areas of the country."<sup>18</sup> A People's Daily editorial commenting on the conference noted that smuggling depended upon official collusion but that even those not directly involved preferred to turn a blind eye.<sup>19</sup>

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<sup>18</sup> Beijing Xinhua August 28 1981, FBIS August 31 1981 p. K6.

<sup>19</sup> Some people, including a number of leading cadres, fail to realize the seriousness and harmfulness of smuggling or to understand the necessity of striking at it. . . Some of them fear that to strike at smuggling will affect the implementation of the policy of opening the door to foreign countries and enlivening the economy. Some look for petty gains while ignoring the entire situation, while others believe that buying and selling smuggled goods is profitable to the particular locality and unit under their own administration. Still others are afraid of stirring up trouble, of offending people and of retaliation. . . It is due to this thinking that smuggling activities . . . have become widespread instead of being given the necessary blows. "Resolutely strike at criminal activities of smuggling," August 29, 1981, FBIS August 31, 1981, p. K7.

### **Junkets and Banquets**

Members of the party-bureaucracy and army had long been accustomed to abusing their power and positions to extract petty gifts from local units, to travel around the country and sightsee as well as feast, at public expense. These abuses also sharply increased with the relaxation of central controls.<sup>20</sup> But the new openness to cultural and

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<sup>20</sup> An article in the Gongren Ribao of June 5, 1979, for instance, reported that:

Work inspections by leading members, learning from advanced experiences of fraternal units and consultation among coordinating units have all been used as excuses for giving dinner parties. In most cases the number of the hosts is much larger than that of the guests. Such extravagant eating and drinking habits are practiced to a shocking degree in some localities. . .

It is good for people to visit advanced areas and units and learn from them. In some study and visiting groups, however, more members join them for purely sightseeing purposes rather than to learn something. More serious still, in the name of making study or inspection trips, some leading cadres travel far and wide, enjoying the sights of mountains and rivers at government expense.

. . . Acting like pampered sons of the bourgeoisie, some cadres indulge in extravagance and ostentatious display. For instance, some leading members prefer to hold large meetings rather than small ones even when matters can be settled by a few people. The purpose of holding meetings is to exchange experiences and discuss work. However, they feel obliged to give some unnecessary mementos to meeting participants. In addition, some units waste considerable amounts of money for entertaining guests. What is more, some leading cadres even resort to dishonest methods to appropriate state funds and materials to build luxury buildings for a few people or to build or expand their own high-class luxury homes. "Resolutely stop extravagance and waste," FBIS June 6, 1979, p. L10.



trade exchange presented the cadres, in addition, with once-in-a-lifetime opportunities to travel abroad. A "fever of going abroad" swept through the bureaucracy, and everyone who could, pulled strings to book passage for themselves and their families -- in the name of "technical and commercial exchange." Under such guises, scientific exchanges often became little more than tourist junkets at public expense.<sup>21</sup>

#### **Siphoning Off State Funds**

Yet these relatively petty abuses paled by comparison with the new possibilities for cadre self-enrichment presented by the government's devolution financial controls to the enterprise and local (provincial and municipal) levels. In the first place, granting the enterprises and local authorities the right to retain their own profits and taxes greatly enlarged the possibilities for managers and local officials to conceal income (as well as output) and use it to increase their own consumption. And this is just what happened. According to one government report, local units have "taken advantage of the reforms to profit at the expense of the state" mainly by five methods,

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<sup>21</sup> See eg. the CPC and State Council Joint Circular prohibiting government and army organizations from using public money for pleasure travel: Xinhua, February 3, 1986.

namely: inflating production costs and retaining profits; evading taxes and defrauding the state; distributing bonuses allowances and subsidies under false pretexts; appropriating public property including state-owned enterprises (turning them into collectively, i.e. locally-owned enterprises); squandering state funds for private consumption.<sup>22</sup>

Officials of the Baoshan Iron and Steel works in Shanghai, for instance, diverted more than US\$86,000 in concealed profits to illegally import for their own use four station wagons (at \$14,500 each) and four air-conditioned sedans (at \$7,100 each).<sup>23</sup> A Yunnan tobacco company falsified its accounts to underrate its profits and output, then used these illegally retained profits to, among other things, buy and barter cigarettes for color television sets from cadres in companies on Hainan Island.<sup>24</sup> Officials diverted capital construction funds to build clubs and reception halls as well private homes for

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<sup>22</sup> Xinhua, May 22, 1984, FBIS May 30, 1984, p. K11.

<sup>23</sup> Xinhua, August 22, 1980, FBIS August 26, 1980, p. 01.

<sup>24</sup> Jingji Ribao, November 7, 1984, p. 1.

staff and workers.<sup>25</sup> Typical of the misappropriation of public funds to build private housing for cadres was a case in Guangzhou, reported by the Nanfang ribao in August 1980, in which leading officials, including the Secretary and Chairman of a local county Party committee built luxurious homes for themselves by obtaining land from the peasants in exchange for reducing the peasants grain taxes, and securing labor and raw materials from them in exchange for approving a sizable migration of the agricultural population to urban areas.<sup>26</sup>

The government's shift from profit delivery to a flat fixed-rate income tax on enterprises also presented new opportunities to illegally withhold funds from the state. The reform was part of the strategy to give the enterprises more direct control, and the assumption was that as enterprise efficiency improved and profits increased, government tax revenues would rise with them. But the result, as we have seen, was that whether efficiency and profits increased or decreased, government revenues fell. The reform encouraged tax evasion because enterprises gained greater control over their own profits, expenses

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<sup>25</sup> Xinhua, January 15, 1980.

<sup>26</sup> August 19, 1980, p. 1, JPRS no. 76942 December 5, 1980, pp. 31-32.

and accounts (as indeed was intended) but this also gave them greater scope to siphon off revenues that previously would have gone to the state. Consequently, as the shift from profit delivery to fixed-rate taxes took place, the press began to complain about "taxdodging enterprises which cheat the state treasury." Officials "pocketed public finances without authorization," they "diverted state funds for construction of luxury buildings and projects, inviting guests to big feasts and giving lavish presents." They used their increased fiscal controls "to reduce or exempt their friends and relatives from taxes." They "fabricated expenditures and kept revenues that should have been turned over to the state."<sup>27</sup> And so on. By December 1984, the Ministry of Finance that tax evasion by enterprises was costing the State Treasury about 3.5 billion yuan a year.<sup>28</sup> By May of 1985, the government reported that half the state-owned and collective enterprises and up to eighty percent of individually-owned enterprises have evaded taxes and "[n]ot only have a large number of enterprises evaded taxes, but the amount of tax

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<sup>27</sup> See eg. Beijing Domestic Service broadcast January 24, 1980, FBIS January 25, 1980 pp. L2-3; and Shenyang Liaonang Provincial Service broadcast December 5, 1980, FBIS December 11, 1980, pp. S3-4.

<sup>28</sup> China Daily, December 7, 1984.

evaded is very large."<sup>29</sup> There seems little the central government can do about it. In late 1984, the government reported that even some of its own tax collection bureaus were implicated in collusion with enterprises to lower their tax rates, in illegally retaining collected taxes and setting up "small treasuries" for expenditures on their own consumption.<sup>30</sup>

### **Speculating on Price Reform**

The government's limited decontrol of prices which was intended to improve the relationship of supply and demand. Instead, for the most part, it simply opened up new opportunities for speculation, profiteering and smuggling -- which in turn, have exacerbated distortions in the economy. Because China's state-set prices were so far out of line with free market prices, the reformers' economists and their Western advisors, notably the World Bank, thought that wholesale decontrol of prices would have caused disastrous shocks to the economy, rapidly driving

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<sup>29</sup> Renmin Ribao, May 13, 1985, p. 1, FBIS May 17, 1985, p. K3.

<sup>30</sup> Xinhua, November 19, 1984; and the China Daily, December 7, 1984. p. 1.

up prices.<sup>31</sup> To bring in price reform more gradually, therefore, the reformers instituted a "two-tiered" system, in which state-set prices were retained for most goods, but in which supply and demand was allowed to determine parallel (usually much higher) market prices for the same items. Since free market prices often were double or several times their counterparts in the state sector, this created a situation in which the temptation to profit from speculation has been irresistible to many cadres.

In line with reforms which granted the enterprises the right to sell above-quota production on the free market, the government has permitted enterprises to raise or lower its prices "within (narrow but vaguely defined) limits." From the outset, however, the press has complained that self-seeking enterprises have taken advantage of this flexibility to "disregard the overall situation" by arbitrarily hiking the prices of goods in short supply thereby "reaping exorbitant profits."<sup>32</sup> In recent years the government has complained that since retail prices of

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<sup>31</sup> See eg. the World Bank Country Economic Report, China: Long-Term Development Issues and Options, pp. 1775-7.

<sup>32</sup> See eg. the People's Daily commentator's article for November 10, 1984: "It is forbidden to indiscriminately hike prices," and an article in the same issue entitled: "Punishment for those who arbitrarily hike prices and disrupt the market," p. 1, FBIS November 14, 1984, pp. K4-5.

grain have been lower than the state purchasing prices (and even internal free market prices are lower than state "negotiated" (yijia) prices for the state purchase of over-quota grain), "some units and individuals have sought to profit from the price differences." Some bought grain at retail outlets and resold it to the state. Some illegally obtained grain coupons and with these, bought up grain and then sold it to the state, often at the higher "negotiated" prices. Others resold fodder to the state as food grain, which was originally allotted by the state at low prices for animal feed to promote animal husbandry. Such practices the government says, "have caused enormous losses to the state".<sup>33</sup> "Speculators rush to buy up commodities that should be purchased by the state by offering higher prices. Thus they disrupt state purchasing plans; speculate on the rise and fall of prices and profit through transactions; drive up prices by hoarding and cornering; evade paying customs duties; resell foreign goods at a profit; and pass off spurious goods as genuine to deceive the masses."<sup>34</sup>

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<sup>33</sup> Zhongguo Fazhi Bao (China Law Journal), May 8, 1985, FBIS May 23, 1985, pp. K6-7.

<sup>34</sup> Nanjing Jiangsu Provincial Service broadcast, July 17, 1980, FBIS July 18, 1980, p. 01; Hohot Nei Mongol Regional Service broadcast, December 19, 1980, FBIS December 31, 1980, p. R1. See also, "Strict financial and economic discipline is an important guarantee for the realization of the Four Modernizations," Renmin Ribao, January 15, 1980, pp. 1,3.

### **Merchant-Bureaucrats**

In December 1984, the Party's Discipline Inspection Commission reported that speculative reselling imported TV sets, as well as steel, cement, fertilizer and many other products had reached "epidemic proportions among the party's organizations and cadres."<sup>35</sup> Even the People's Liberation Army, once the vanguard of Chinese socialism, had become deeply involved in "buying up materials . . . and illegally trading in cars, rolled steel, color TV sets, and other commodities in short supply."<sup>36</sup> In May of 1985, the government disclosed a fraud involving some four million yuan, twenty companies and eight provinces in which 100 Fiats had been bought at Y35,000 each in Henan Province and resold elsewhere for up to Y47,000 each. But the most dramatic disclosure came in August of last year when it was revealed that thousands of officials and military personnel had been involved in a vast network to smuggle in some 89,000 imported automobiles from Hainan island to the interior provinces (Guangdong Province's

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<sup>35</sup> China Daily, December 13, 1984 and January 30, 1985.

<sup>36</sup> Ming Pao, February, 25, 1985, p. 5, FBIS February 26, 1985, pp. W3-4.



Hainan island had been designated an "open port" with extensive import privileges). The government Military Discipline Inspection Commission reported that between January 1984 and March 1985, the Chinese Navy used its ships and planes to smuggle in, besides cars, 122,000 motorcycles, more than 2.8 million TV sets, 252,000 video recorders, thousands of videotapes and radio-cassette recorders from Hainan to Sichuan and other provinces.<sup>37</sup> According to one report, the officials involved raised more than 4.2 billion yuan by getting local branches of the industrial and commercial and agricultural banks to inflate their fees, then used this to buy US\$570 million in foreign exchange. "This was then used to buy foreign goods, which were then resold at double or triple the price to 27 provinces, autonomous regions and municipalities." Some 872 Chinese enterprises were said to be involved in the profiteering scam.<sup>38</sup> The ensuing scandal rocked Beijing and delivered a huge setback to Deng's Open Door policy. Again, it seems there is little the government can do about such tendencies so long it continues its policy of opening to the West. Indeed, it

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<sup>37</sup> Xinhua, July 31, 1985; Ming Pao, August 21, 1985, p. 6; and Jiefang Ribao, August 17, 1985.

<sup>38</sup> Xinhua, July 31, 1985.

was reported that smuggling has become "rampant" even in government anti-smuggling squads.<sup>39</sup>

Handing over foreign exchange transactions to enterprises and local units has resulted in similar problems for the central government. Some units, the government reported, pocketed foreign exchange earnings which "should have been turned over to the state" and "put it into their collective funds and used them to import automobiles or other nonproductive commodities for their own units or deposited the money outside China to set up small treasuries [for discretionary use beyond government supervision]."<sup>40</sup>

#### **Buying Off the Workers**

It is in this context of deepening corruption of the party-state cadres that we can best understand the government's complaint in recent years about the pattern of "wanton" distribution of bonuses. Enriched beyond their wildest imaginations through both legal and illegal means, local officials and factory directors have sought to cover themselves by assuring the complicity if not direct collusion of their subordinates in their collective plunder of

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<sup>39</sup> Xinhua, March 15, 1984.

<sup>40</sup> Renmin ribao, February 27, 1981, p. 2, FBIS March 12, 1981.

the economy. Under the maoist regime, this took the form of a modus vivendi between the factory management and the workers in which the latter turned a blind eye to official corruption while management let the workforce come in late, take time off with pay, work on their own projects on company time, etc. Liang Heng, who in the early seventies was employed in a metal working factory in Changsha wrote that in his factory the workers<sup>41</sup>

knew that no matter how inefficient they were and how many chairs they made for their friends, they would never lose their jobs; whether they worked hard or did nothing, they would still earn the same low salaries. Everyone saw the factory leaders give away truckloads of coal and steel to cadres in the countryside so they themselves could eat watermelon in summer and oranges in fall; the leaders' children were among the first to come back from their stints as Educated Youths, all with good jobs. No one criticized them, my fellow workers pointed out, so why shouldn't ordinary workers "eat Socialism" too? Compared with the feasts of the leaders, their share was only the barest nibble. (Emphasis added).

To this situation, Deng's reforms added nothing except to so greatly enrich the cadres and factory managers that they could well afford to throw a few more crumbs to the workers. In recent years, the government has complained that the cadres try to cover themselves, as one report put it, by "corrupting others so as to spread responsibility. In the past, only a small group of people indulged in

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<sup>41</sup> Liang Heng and Judith Shapiro, Son of the Revolution, (New York: Alfred A. Knopf, 1983), p. 221.

heavy eating and drinking. But now, such groups have been widened to include people who have access to such information. . . In this way, all parties are involved and people had to protect one another."<sup>42</sup> The government has accused enterprises of "feathering their own nests at the expense of the state." They "indiscriminately issue bonuses for the sake of ingratiating themselves with people, or for winning 'appreciation' from those above and 'support' from those below at the expense of the state."<sup>43</sup> In one case reported in December 1985, the leadership of the Beijing Municipal Public Utilities Bureau's Gas Company, including the deputy secretary of the party committee and director of the bureau, embezzled some 9 million yuan. Of this, the leadership distributed some 4.2 million yuan among themselves, paid out 600,000 yuan in bonuses and spent another 240,000 yuan bribing concerned leading cadres and departments.<sup>44</sup> These may or may not be typical proportions; we have no way of knowing. But it is indicative in

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<sup>42</sup> Dazhong Ribao (The Masses Daily), August 29, 1980, p. 2.

<sup>43</sup> Liaoning Ribao, April 9, 1982, p. 3, FBIS May 4, 1982, p. S3.

<sup>44</sup> Xinhua, December 19, 1985, FBIS December 20, 1985, p. K17.

a general way, of some of the motivations behind the pattern of "wanton" distribution of bonuses that has grown up since the introduction of the reforms.

### **The "Proper Way" to Get Rich**

In rejecting maoism, the market reformers cast aside whatever ideological restraints maoist revolutionary asceticism once exerted over bureaucratic proclivities toward indulgence and corruption. Yet paradoxically, for reasons we shall explore in chapter five, the reformers resisted the growth of very market forces that could have exerted another kind of discipline over the bureaucratic managers. Consequently, in the absence of such restraints, decentralization and marketization just gave the ideological go-ahead and at the same time created huge new incentives for cadre corruption. Symptomatic of the inherent contradictions in the reformers' strategy, has been their efforts to curb the entrepreneurial "excesses" of their over-zealous cadres: Having urged the cadres on to become "socialist entrepreneurs," by the mid 80s, the reform leadership reversed itself, and began attacking the cadres for "seeking private interests at the expense of the interests of the state and the people."<sup>45</sup> "Some comrades" the press

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<sup>45</sup> Xu Xun, "Officials doing private business are extremely harmful to the state," Renmin Ribao, March 11, 1985, p. 5, FBIS March 15, p. K15.

complained, "have a one-sided idea, thinking that 'the more money one can make, the more successful one should be regarded.' In order to seek 'wealth' for themselves or their small collectives, they even go so far as to sacrifice the overall interests of the state and the people."<sup>46</sup> But, it might be asked, what else, really, should the reformers have expected? As the government readily conceded, given their dual role as "officials" and "businessmen," a "clear line of demarcation can hardly be drawn between the two roles of those officials engaging in profit-making business."<sup>47</sup> And just as there is no separation between the government and the economy, i.e. between the state and "civil society," as under capitalism, neither is there any separation in China between the state-economy and the legal-judicial apparatus. The machinery of law enforcement is only a (very) subordinate part of this same state-economy, and as such, subordinate to the interests of the bureaucratic hierarchy that runs the state-economy. Thus, although the reform leadership has repeatedly declared that "state officials" should not

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<sup>46</sup> "Only prosperity attained through labor in accordance with the law is glorious," Renmin Ribao commentator's article of August 10, 1985, p. 1, FBIS August 21, 1985, p. K1.

<sup>47</sup> Xu Xun, op. cit., p. K14.

be engaging in private "profit-making businesses," this has been regularly ignored by everyone, especially in view of the widely known (and resented) fact that the children of the leading reformers, Deng and Zhao, have led the way in privatization.

In sum, given the absence of ideological and legal, as well as real market restraints, it was virtually a foregone conclusion that decentralization in the context of a part-market-mainly bureaucratic economy would only further undermine the leadership's ability to improve the performance of the economy because it turned over control of scarce resources to lower-level officials who had even less interest in rationalizing the economy than the central ministries.

## CHAPTER 5

### CLASS STRUCTURE AND ECONOMIC RATIONALITY: THE CONTRADICTIONS OF MARKET SOCIALISM: 1978-88

In the heyday of reform in the late 70s and early 80s, China's reformers and their Western promoters, asserted that the key to reforming China's stultifying bureaucratic economy was to be found in a broad decentralization and marketization of the economy. In their view, decentralization and marketization -- within the context of continuing state ownership of the major means of production and overall state control of the economy -- would force industrial and agricultural producers to adopt new capitalist-like methods which would, in turn, bring about a broad restructuring, reorganization, and overall rationalization of production, investment, product distribution, and incomes policy, along the lines of a market economy. As we have seen in the previous chapters, with some important exceptions, this did not turn out to be the case. In some respects market reforms worked as expected. But for the most part, the decade of sustained reform has produced results that are very much the opposite of what was intended or expected.

This is not to say that the reforms have not brought major improvements. Clearly, they have. Production has



surged, incomes are up, foreign trade has vastly expanded, produce and consumer goods are available in unprecedented quantities and varieties. Despite the continuing restraints on political and cultural freedom, the austerity and uniformity of the Mao era is history. These gains are in part attributable to planned changes such as state-planned increases in procurement prices and wages, deliberate shifts in state investment from heavy to light industry/consumer goods production, and the reopening of foreign trade. But, more importantly, most of the gains in farm output and consumer goods and services have come from the rapid growth of the free market sector, side-by-side with the state-owned/state-planned economy. Although this free market production presently accounts for from a quarter to a third of gross national output, it has been crucial in supplying badly needed consumer goods and services. In this respect, the market reforms "worked" in the sense that the expansion of production for market has gone very far to supplement the state-planned sector.

But the main goal of the reform strategy was not just to supplement the (badly) planned state sector, but to transform the state sector itself by bringing market reforms into the planned sector -- to create, in the words of the reformers, a "planned commodity economy." In this respect, market reform has been a disaster. For, instead of rationalizing and correcting the plan, the growth of market

forces within and beside the state-owned/state-planned sector has caused massive dislocations, undermining and subverting the plan, and forcing the government to repeatedly over the past decade to recentralize the economy, in the effort to prevent further massive dislocations. As we have seen at length, the attempt to introduce market forces while simultaneously enforcing state planning, produced neither rational planning nor market rationalization.

As we saw in chapter two, the contradictory results of this strategy have become apparent even in the agricultural sector -- which until recently had been the one bright spot in the reform strategy. We saw that to the extent that market reform has been successful in the rural economy, this has been largely because it has actually resulted in some significant, if limited, capitalist development -- mainly in sideline production, in secondary crops, and in trade. To the extent that capitalist production relations actually developed on the land, this development indeed brought competition and specialization; and this in turn brought rising productivity and rising incomes -- as the reforms had hoped. Yet, paradoxically as we saw, the peasants' quick grasp of market economics soon posed a problem, instead of a boon, to the reformers. This was because, while seeking to introduce some market forces into the rural economy, the government still sought to enforce the state agricultural plan, which they did mainly by enforcing state-set prices and by con-

trolling key agricultural producer inputs like fuel and fertilizer. Yet it became increasingly difficult to enforce their plan, precisely because the mobility which resulted from decollectivization and market reforms made it possible for peasants to escape from low-wage agriculture, by moving into rural industry and trade, or by fleeing the countryside altogether to seek higher paying work in China's cities. By the mid 80s, the government's agricultural plans collapsed in the face of peasant market preferences. With output falling, the government was forced to reintroduce rationing of many foods. To slow the flight from the land, the government has moved to restrict peasant mobility, and to force masses of migrants out of the cities and back to the land. To reassert planned production, the government has reimposed price controls and closed many rural free markets. In short, when market forces threatened the state's agricultural plan, the government intervened to reinforce the plan.

Industrial reform has followed a parallel course. As we saw in chapter three, decentralization, marketization, and the opening to the West promoted the growth of light industry and a tremendous expansion of the supply of consumer goods. Yet, contrary to the reformers expectations, the preferences of the industrial managers soon ran up against those of the reform leadership in Beijing. As we noted at the outset, the reforms aimed to transform China's industrial managers into cost-cutting profit-maximizing

"socialist entrepreneurs." As it turned out, we saw that despite gaining substantial managerial and financial autonomy, and despite schooling in Western management practice, by and large, China's enterprise managers continue to pursue highly irrational patterns of investment, output, and reward. Generally speaking, instead of maximizing profitability they seek to maximize firm income by maximizing costs (viz. inputs), including wages and investment funds -- regardless of profitability. Instead of cutting costs they have splurged on huge imports of goods, machinery, even whole factories -- often without regard for need, for necessary ancilliary facilities, for power to run them, etc. More than that, instead of investing productively, they strive to divert as much resources as possible from production to consumption. Instead of cutting waste and shedding redundant facilities, stocks and labor, they pursue "blind expansion" of their own units of production regardless of market need and heedless of efficiency, even falling into debt to do so. Instead of efficient producers driving the less efficient out of business, small-scale uneconomic producers flourish draining resources from larger more productive plants, often idling the more efficient firms. Instead of abolishing egalitarianism by tying reward to performance, managers distribute bonuses indiscriminantly, and massively overspend on the wage bill, even hiking wages in factories that are effectively bankrupt. Instead of specializing by comparative

advantage, they use their retained profits to reinforce their capacity for self-sufficiency. Instead of innovating, improving performance, and competing on the market, managers continue to resist many technical innovations and compete bureaucratically by throwing up barriers to trade in order to force the sale of locally produced products, regardless of quality, technical level, or price. Instead of rationalizing production to compete effectively on the world market, producers often dump goods overseas at below cost, just to bring in foreign exchange. Instead of borrowing from international bankers with a view to real need and the ability to repay, state firms and trading agencies have borrowed massively to fund imports of producer and consumer goods, heedless of the trade deficit, and doubling China's debt in just the two years between 1987-89. And so on.

The net result of all this, as we noted, is that after a decade of industrial reform, China's industrial development is still characterized by stagnant if not falling productivity growth despite ever growing investments, massive duplication, stupendous waste of investment, resistance to innovation, lack of specialization, tremendous overproduction in some lines side by side with huge shortages in others, continuing imbalance with a bias toward heavy industry, abysmal labor discipline and no correspondence between performance and reward, etc. etc.

## **I. THEORY OR PRACTICE: WHERE DID THE STRATEGY GO WRONG?**

The question, of course, is what went wrong with the market socialist strategy? Why, after all the capitalist/market reforms, has the economy, especially the industrial economy, failed to behave as expected? Why isn't there competition? Why don't industrial managers invest according to the imperatives of the market, viz. cut costs, innovate, specialize? Why doesn't management make economically rational investment and reward (wage/bonus) decisions? Why hasn't labor responded to tightened discipline and bonuses with greater productivity? Why have the reforms proved utterly incapable of correcting the long-established patterns of economic irrationality which, instead of lessening, have become more intense and pronounced under Deng's regime. And finally, why, despite its stated intentions to the contrary, has the political leadership regularly intervened in the economy in ways which defeat every major move toward the freer mixed market-planned industrial economy they ostensibly wish to realize?

### **Conservatives vs. Radicals?**

The short answer, is that the bureaucracy -- and not just the footdragging conservatives and unreconstructed maoists, but the reform leadership itself -- has refused create conditions which are necessary to facilitate the operation of capitalist laws of motion. The conventional explanation, in mainstream academic and journalistic discus-

sions of China (as well as the Soviet Union), is that the theory of market socialism is essentially sound, but that elements within the bureaucracy are impeding reform. According to this view, China's political leadership is divided between "reformers" and "conservatives." The reformers (headed up by Deng Xiaoping and Zhao Ziyang) want to push ahead to much greater marketization, giving the market a dominant and the plan a secondary role. But the reformers must constantly struggle against, and are occasionally thrown back by, the conservative faction (led by Chen Yun, Peng Zhen, and Party ideologists Hu Qiaomu and Deng Liqun) comprised of stalinist bureaucrats, maoists, and all those entrenched bureaucrats in the apparatus who feel threatened by the potential of reform. Thus, the future of reform is seen hinge critically upon the continued political hegemony of the chief reformers at the top.<sup>1</sup>

This theory has extraordinary currency and resiliency despite its sloppy empirical basis. Its chief virtue seems to

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<sup>1</sup> For a recent exegesis of this view, see the articles by Robert Delfs in the Far Eastern Economic Review special issue on China of March 19, 1987, pp. 55-62. For comparisons of the problems of reform in China vs. the Soviet Union, see Marshall I. Goldman and Merle Goldman, "Soviet and Chinese economic reform," Foreign Affairs, Vol. 66, No. 3 (1987/88), pp. 551-73; and Christopher S. Wren, "Breaking out," The New York Times Magazine, August 14, 1988, pp. 22-25, 28-29 (Wren was formerly the Times bureau chief in Beijing).

be the evident simplicity of its theme, which lends itself well to the writing of countless Op Ed pieces and articles based on a standard formula and requiring little real analysis. Of course, Deng and Zhao have been the primary ideological exponents of reform, and they have also actually supported some economic reforms. But to understand why the reforms have failed it is crucial to pay as much attention to reforms that have been resisted by the leading reformers as to those that have actually been adopted. It is equally important to take into account the fact that Deng has personally led the government recentralization of 1979, and he and Zhao have initiated or endorsed every retrenchment since then, up to and including the most recent recentralization of the economy in the fall of 1988.<sup>2</sup>

Some China experts, like Professor Harry Harding of the Brookings Institution, have tried to account for the inconsistencies of reform leadership policies by drawing a distinction between what he calls "radical" and "moderate" reformers. In his version, radical reformers (led by Zhao Ziyang) want the market to "be paramount, the plan secondary." They "favor the development of markets for almost

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<sup>2</sup> For a brief history of Deng's inconsistent attitude to political and economic reform over the years 1979-87, see Harry Harding, China's Second Revolution: Reform After Mao, Washington, D.C.: Brookings Institution, 1987, pp. 83-84 and 91-92.



all factors of production, including capital and labor, as well as for every type of raw material and industrial machinery."<sup>3</sup> By contrast, moderate reformers "would restrict the operation of the market to agricultural goods and a few small manufactured commodities." The moderates see the market as an important, but "supplementary mechanism for the allocation of goods and services and the determination of prices, with the state continuing to occupy the dominant position."<sup>4</sup> Harding deals with Deng's contradictory attitudes toward reform, by interpreting his role as that of a "balancing force" between the two wings of the reform movement "but in ways that have usually supported the more ambitious objectives of the radical reformers."<sup>5</sup>

But Harding's version doesn't really improve the theory's explanatory capacity. Obviously, Deng and other so-called moderate reformers have been dragging their feet on economic reform. But the problem is, so have the so-called radical reformers, notably Zhao Ziyang. For example, with respect to the relationship of the plan and the market, here

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<sup>3</sup> Ibid., p. 78.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid., p. 91. (emphasis added).

is how radical free marketeer Zhao viewed the relationship in 1982:<sup>6</sup>

Ours is a unified socialist nation. We must have a unified plan and a unified domestic market . . . In order to strengthen centralization and unification in economic work, we must adhere to the overall plan on major issues while allowing freedom on minor issues. We must advocate centralism on major issues while allowing decentralism on minor issues. The commodity price and revenue system must be centralized and unified . . . No matter what reform is to be carried out, the general guideline is to combine the strengthening of centralization and unification with the activation of the economy and to bring into full play the initiative of localities, departments and the principle of taking the whole country into account.

Or again, the "historic" October 1984 "Decision" of the Central Committee "Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure," in which was advertised by the chief reformers as their "blueprint" for industrial reform, says nothing about giving market forces a dominant, let alone a "paramount" role, and makes no mention of creating markets for the major factors of production. On the contrary, the document clearly states that China is a "socialist economy practic[ing] a planned economy on the basis of public ownership of the means of production." (p. VII). The enterprises are to be encouraged to improve their efficiency by granting them

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<sup>6</sup> "Zhao Ziyang's speech at industry conference," FBIS, April 1, 1982, pp. K6-8 (emphasis added), quoted in Robert Dernberger, op cit. p. 31.

greater independence "on the premise of following the state plans and subjecting [themselves] to state control." (p. VI). That is to say, "the socialist state institutions must manage, inspect, guide and regulate the activities of the enterprises . . . through planning and by . . . administrative and legal means; it must use taxation and other means to concentrate in its treasury that part of enterprises' net income which should be used in a unified way . . ." (p. VI, emphasis added). Furthermore, the state will continue to "appoint and remove the leading members of the enterprise," and most importantly, the state (N.B. not the market) will "decide on the establishment of enterprises," their removal to other places, their switching over to other lines of products, their merger with other enterprises, their suspension of operations, or closing down." (p. VI). Finally, while the document does call for continued efforts to shift more commodities under planning from mandatory to guidance plans (p. VIII), still, the document explicitly insists that "ours is on the whole a planned economy not a market economy that is entirely subject to market regulation. . . production and exchange subject to market regulation are confined mainly to certain farm and sideline products, small articles of daily use and labor services in the repair trades, all of which play a supplementary but indispensable role in the national economy." (p. VIII,

emphasis added).<sup>7</sup>

Now it is true that in recent years, Zhao Ziyang has made statements which might be taken to go beyond these limitations. For example, in his March 1986 report on the Seventh Five-Year Plan," and again in his October 1987 speech to the 13th Communist Party National Congress,<sup>8</sup> Zhao called for the establishment of "a new socialist macro-economic management system by gradually changing from mainly direct to mainly indirect control in its management of enterprises." Again, mandatory planning is to be reduced, guidance planning extended. There is to be increasing use of economic levers such as prices, taxes, credit, interest rates, exchange rates, and wages. Furthermore, "systematic measures must be taken to open up markets of capital and technology and promote a rational flow of labour." "We will gradually establish a system in which the state sets the prices of a few vital commodities and labour services, while

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<sup>7</sup> The foregoing précis of the 1984 Decision is largely abstracted from Professor Robert Dernberger's careful reading of that document, for which I am indebted. Dernberger's paper is a good antidote to the ungrounded wishful thinking that is so pervasive in current analyses. See Dernberger, op. cit. pp. 17-19 and passim.

<sup>8</sup> "Report on the Seventh Five-Year Plan," March 25, 1986, in Beijing Review, April 25, 1986, pp. I-XVI; and "Advance along the road of socialism with Chinese characteristics," October 25, 1987, in Beijing Review Publications, (n.d., n.p.) pp. I-XXXIII.

leaving the rest to a pricing system under state guidance and to market regulation."<sup>9</sup> But perhaps most dramatically, in remarks that captured headlines in the West, Zhao told the visiting director general of the General Agreement on Tariffs and Trade in October 1987, that in a few years time "only about 30% of China's economy will remain subject to central planning."<sup>10</sup> Needless to say, this won much applause in the Western business press.<sup>11</sup>

Are we to understand, then, that if the radical reformers have their way, the market will assume the dominant role and the plan the secondary role, that relatively unfettered free market prices will dictate the allocation of resources and incomes, that the means of production are to be put on the block and auctioned off, as Professor Harding would have us believe? Not quite. For Zhao does not fail to tell us, in the same breath, that "of course, the kind of commodity economy we want to develop is,

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<sup>9</sup> "Report" p. XIII. (emphases added). Speech to the 13th Congress, p. XI.

<sup>10</sup> Beijing Review, November 9-15, 1987, p. 10.

<sup>11</sup> For some samples see Robert Delfs, "Shareholders arise!," Far Eastern Economic Review, November 5, 1987, pp. 12-14; "China's value theory of labor," Wall Street Journal editorial, September 8, 1986; and Maria Shao, "Zhao gives China a swift kick toward a free market," Business Week, November 16, 1987, p. 89.

on the whole, a socialist commodity economy based on public ownership, and economy in which distribution is made according to one's work and which is planned and under control. The [1984 Decision] points out explicitly that socialist economy is a planned commodity based on public ownership."<sup>12</sup> And to make sure that there was no confusion about what regulates what, viz. who shall set the prices, wages, taxes, credit interest rates, the "economic levers" which some suppose are to operate independently and correct the plan, Zhao told the Communist Party that: "On the whole, under the new economic mechanism, the state regulates the market, and the market guides enterprises." Specifically Zhao reiterated, "The state regulates the relation between supply and demand through economic, legal, and administrative means and creates a favourable economic and social environment in which enterprises are guided towards correct management decisions."<sup>13</sup> As recently as August 1, 1988, Zhao told a visiting Swiss economist that: "We are not prepared to change the situation in which public ownership takes the dominant role. . . We will let the State adjust the market,

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<sup>12</sup> "Report on the Seventh Five-Year Plan," p. XIV.

<sup>13</sup> Ibid., pp. XI-XII.

and let the market guide the enterprises."<sup>14</sup> In short, even in the most radical vision of reform, state ownership will continue to predominate, and it is not the market which will regulate the plan, as Professor Harding and others imagine, but rather the plan which will regulate the market.<sup>15</sup>

### **Reformers Against Reform**

But more important than what the reformers say is what they actually do. And in this respect too, the radical reformers' actions have defined the limits beyond which they are unwilling to venture. Whereas, to a significant, although not unlimited extent, the reformers did let go of

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<sup>14</sup> China Daily, August 1, 1988.

<sup>15</sup> Such inconsistencies on the part of Deng and Zhao should caution against efforts to interpret leadership policies in terms of the conflict of ideological factions. This is not to argue that individuals and groupings within the leadership do not have divergent views with respect to centralization and liberalization. It would be surprising if they did not. But that does not mean that one can explain major policy shifts, say from reform to recentralization, by the rise of one faction and the fall of another. It is not necessary, in my view, to resort to such an ideologically centered view with the inconsistencies such interpretations necessarily entail, nor is it necessary to resort to real or imagined power struggles to explain change. As I tried to indicate above and in the preceding chapter, such policy reversals have invariably been in response to objective economic trends, usually in response to unanticipated difficulties caused by previous policy initiatives, and these turns have, by and large, been accepted and backed by the entire leadership, regardless of their personal ideological predispositions.

the peasants by abandoning collectivized agriculture, by contrast, they refused to set industry free to live or die by the laws of the market. Despite all their talk, the reformers only implemented very partial reforms in the industrial sphere. Specifically: they granted the industrial directors substantial autonomy with respect to investment and wage decisions. They also gave them a large measure of authority over the disposition of over-quota output. But they consistently refused implement other necessary and essential institutional reforms without which a true market, and hence market pressures to compete, economize resources, specialize, improve efficiency and so on, could not possibly develop.

First, despite their ceaseless talk about giving markets a greater role in the industrial economy, the reformers have steadfastly refused to abandon state monopolies over the key factors of production: capital, labor, land and materials. Nearly all industrial means of production (excluding village industries), and at least three-fourths of raw and semi-finished materials, and finished products, continue to be allocated exclusively through the state planning and distribution system.<sup>16</sup> Nearly all sig-

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<sup>16</sup> University of Michigan economist Robert F. Dernberger estimates that at least as of 1983-84, the state planned economy still encompassed three-fourths of all economic activity in China, with the remainder being considered as within the market. By sector, Dernberger estimates that two-thirds of all industrial output is within the plan while one-third is for the market (i.e. all of the produc-



nificant means of production (including factory buildings, machinery and equipment) and all land, remain the property of the state or its subunits. Similarly, even after a decade of reforms, China's system of labor allocation remains more rigidly controlled by the state than in the Soviet Union or East Europe.

Secondly, despite their perennial pledges to "resolutely" carry out price reform next year (never this year), the reformers have refused abandon price controls and let free market prices, i.e supply and demand, determine production and factor allocation. Instead, as we have seen, they continue to enforce planned production, regularly intervening to override enterprise independence whenever enterprise goals conflict with the state plan. And, on various pretexts, they have postponed major price reforms year

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tion of individual/private enterprises, two-thirds of collective industry production, and, one-fourth of the output of state-owned enterprises). For commerce, he estimates that three-fourths of all retail trade is within the plan. Eighty-five percent of transport activities are within the plan. Two-thirds of construction activities are within the plan. And eighty percent of agricultural output is either for direct consumption (the vast bulk) or produced for planned procurement. See his "Economic Policy and Performance," in J.E.C., China's Economy Toward the Year 2000, (1986), vol. 1, pp. 30-31. Private sector production may have grown somewhat in recent years, but has certainly fallen back since the retrenchment in the fall of 1988.

after year.<sup>17</sup> Most recently, for instance, Zhao's 20,000 word programmatic March 1987 report to the National People's Congress (cited above) "could have been drafted by the conservative faction," in the words of one reporter, because, while it gave general assurances of continued reform, in fact it announced retrenchment: central planning was revived, the bankruptcy law was suspended, price reform was postponed again in favor of the immediate need for "stabilization," and plans to convert state enterprises into joint stock corporations were put back on the shelf.<sup>18</sup> Moreover, whereas in his March 1986 report on the Seventh Five-Year Plan (cited above), Zhao stressed that "state supervision on enterprises should be changed gradually from mainly direct to mainly indirect control," in his March 1987 report, he didn't even call for reduced mandatory planning. Instead,

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<sup>17</sup> Last year (1987), for example, Zhao conceded that "Reform this year will be confined to readjusting control over a very small number of products whose prices have to be changed, and we must see to it that the rise of the general price level is smaller than it was last year. State commerce should continue to play its part in stabilizing prices, and we must make a point of strengthening control over market prices . . . ." "Report on the work of government," March 25, 1987, published in Beijing Review, April 20, 1987, p. XIV. (emphasis added).

<sup>18</sup> Ellen Salem, "Slow boat for China," and "An end to equity: China puts its stockmarket experiment on hold," Far Eastern Economic Review, April 23, 1987, pp. 51-53, quoted remarks from p. 52.

Zhao conceded that "enterprise behaviour cannot, on its own, meet the overall state policy, nor can it respond to market changes rationally and in good time . . ." Therefore, he continued, we must implement "the 'three guarantees and three restrictions.'" This means we must guarantee the construction of projects included in the plan, of productive projects and of key projects, while restricting projects that are outside the plan, non-productive and non-key."<sup>19</sup> Again, Zhao the free marketeer.<sup>20</sup>

Thirdly, despite continual promises, the reformers refused to let the managers improve and discipline the industrial workforce giving them the right to hire and fire at will, and they even extended this refusal to China's Special Economic Zones where Western capitalists were supposed to be granted greater freedoms with regard to hiring and firing.<sup>21</sup>

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<sup>19</sup> "Report on the work of government," March 25, 1987, Beijing Review, April 20, 1987, pp. VII, XI.

<sup>20</sup> Zhao's recent reluctance to push for more radical reforms has prompted some analysts to see Zhao himself as the new "balancing force" -- thus Robert Delfs: "Zhao's balancing act," Far Eastern Economic Review, April, 9, 1987, pp. 12-13. But one might ask, if Deng and now Zhao are both centrists, who then are the real reformers?

<sup>21</sup> Western capitalists have balked at the restrictions the Chinese government places on hiring and firing in the joint venture enterprises, and this has been a critical reason why the multinationals' enthusiasm for investments in China has cooled in recent years. For the official view for foreign consumption, see Yue Haitao, "How to hire and dismiss employees," (part nine of "The ABC of investing in

Fourthly, despite endless declarations about the need for bankruptcies, the reformers, as we have seen, have refused to abandon state subsidies and the let the enterprises sink or swim by the laws of market competition.

But the question, of course, is how could the firms specialize without relatively full mobility of factors? How can they respond to market opportunities if they're not free to change their product mix, if this is still mainly dictated by the plan? How can they cut costs by shedding excess stocks, in-house machine-making facilities, redundant labor if they can't go out and buy (or hire) what they need on the market, because most of these resources are still allocated through the planning apparatus? Or again, if the managers can't freely hire and fire labor, how can they discipline the workforce, or how can they exchange those they've been allocated, for others with needed skills, to optimize the workforce? And without market penalties (viz. bankruptcy and

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China"), in Beijing Review, October 12, 1987, pp. 24-5. For some insights into the realities of labor relations in joint enterprises, see, e.g. James Sterba, "China turning foreign investors bitter," Asian Wall Street Journal, July 18-19, 1986; Adi Ignatius, "Foreign firm hiring workers in China hits a catch-22: obstinate ex-employers," Wall Street Journal, March 30, 1988; and James R. Schiffman, "Supplying workers to foreign concerns sets of a war among Chinese agencies," Wall Street Journal, January 5, 1988.

unemployment) where is the pressure to urge the firms to economies and greater efficiency?

## II. RULING CLASS REPRODUCTION AND SELF-LIMITING REFORM

But all this only raises the larger question, namely, why won't the reformers set the firms free? Given their incessant talk of expanding the market, of promoting competition, of freeing prices, of getting the state out of the economy, and so on and so forth, why don't they quit talking about it and do it? Why don't they set the firms free to live or die by the market? Why won't they let Darwinian competition "select the strong" and "eliminate the weak" (in Zhao Ziyang's words)?<sup>22</sup> In short, why won't they do what's necessary to make the market reforms work?

It has been the purpose of this thesis to demonstrate that the market socialist strategy was hopelessly contradictory and necessarily doomed from the start. As we saw, China's market socialists based their whole reform strategy on the presupposition that China's bureaucratic economy could be made to work, more or less, like a market economy -- while simultaneously preserving the structure of

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<sup>22</sup> From his "Report on the Seventh Five-Year Plan," March 25, 1986, published in Beijing Review, (April 21, 1986), p. xii.

bureaucratic property (viz. state ownership of the major means of production and the social surplus).

It is my contention that this strategy was doomed to failure precisely because to really make the market work, it would have been necessary to bring in institutional changes -- crucially capitalist social-property relations (free labor and free capital). In my view, the market/capitalist dynamic (of competition-driven efficiency, etc.) that the reformers wanted to generate is entirely dependent upon and inconceivable without the predominance of capitalist social-property relations. This means then, that to elicit such a market dynamic the ruling bureaucracy would have to sell off the means of production and give up the state's (coercive) control of labor. Yet, the problem of them is that any broad move to introduce such capitalist property relations the state sector would directly threaten the fundamental structure of bureaucratic class power, which rests upon the system of bureaucratic surplus extraction through the state plan, which in turn, is guaranteed by the bureaucracy's "ownership" of the state, its industries and its extractive tax system. Since the reformers cannot allow capitalist property relations to develop on an extensive scale without, in the process, undermining, if not abolishing, their own means of reproduction (the system of bureaucratic surplus extraction), they have, therefore, had little choice but to try to elicit a capitalist dynamic within the context of a

still fundamentally bureaucratic economy. And this is, in my view, to attempt the impossible. In short, it is my argument that however much the reformer-bureaucrats genuinely wish to employ market forces to correct the plan and alter the behaviour of managers, administrators, and workers, they cannot do so, because to permit market forces to predominate would destroy the bureaucracy's own means of subsistence and reproduction as the dominant social class. Consequently, because the reformers' overriding concern must be to preserve the structure of bureaucratic property and bureaucratic surplus extraction, this means that they must act fairly systematically (if often unconsciously) to subvert their own reforms, such that the entire reform project becomes essentially self-limiting.

Now the theoretical presupposition on which my interpretation rests is, of course, Marx's classic proposition that the economic development of any given society is determined, in the first instance, by the prevailing historically-given class structure, or property relations, of that society. Marx's thesis has been elegantly restated by Professor Robert Brenner as follows, and this has served as the starting point for my own interpretation:<sup>23</sup>

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<sup>23</sup> "The social basis of economic development," in Analytical Marxism, John Roemer, ed., (Cambridge University Press, 1986), pp. 26-27. For a similar statement see idem., "Agrarian class structure and economic development in pre-industrial Europe," Past & Present, no. 70 (February 1976), pp. 31-32. Marx's own formulations may be found in the famous "Preface" to A Contribution to the Critique

By property relations, I mean the relationships among the direct producers, among the class of exploiters (if any exists), and between the exploiters and producers, which specify and determine the regular and systematic access of the individual economic actors (or families) to the means of production and to the economic product. In every social economy, such property relations will exist, and make it possible for the direct producers and exploiters (if any) to continue to maintain themselves as they were -- i.e. in the class position they already held, as producers or exploiters. Since this is so, the property relations will, to a large degree, determine the pattern of economic development of any society; for that pattern is, to a very great extent, merely the aggregate result of the carrying out of the rules for reproduction of the direct producers and exploiters. So, the causal sequence runs roughly as follows: form of property relations -- rules for reproduction of the individual economic actors -- long-term pattern of economic development/non-development.

### **Classes and Class Strategies in China's Bureaucratic Mode of Production**

Now with respect to post-revolutionary China, my hypothesis has been that economic development has been broadly determined by the bureaucratic class/property relations which were established in the course of the revolution

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of Political Economy (various edns.); "Genesis of capitalist ground rent," in Capital, vol. 3, (Middlesex: Penguin 1981), chap. 47; and the "Introduction" to the Grundrisse (Middlesex, England: Penguin 1973).



and the immediate post-revolutionary period.<sup>24</sup> In China's bureaucratic mode of production, industrial workers are expropriated and without direct access to means of production, as they are under capitalism. But in the bureaucratic system these are the property of the state, which is "owned" by the collective party-bureaucracy. So while the workers have no choice but to sell their labor power, they do not have to go through the market to do so, since there is in effect only a single employer, the state. On the other hand, since surplus extraction is collectivized and centralized in the bureaucratic property form, the bureaucracy also does not have to go through the market to obtain its subsistence because it takes what it requires for subsistence directly out of the economy, essentially by requisitioning. The bureaucracy's relationship with the peasantry is also based essentially on non-market coercive surplus extraction, partly through direct taxation, but mainly through unequal exchange which is made possible by the state's huge monopoly as the main (for some crops, only) purchaser, which allows

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<sup>24</sup> I have argued elsewhere the thesis that Mao's revolution is best understood as the first of a wave of "bureaucratic revolutions" in the post-war period. See my "China and the crisis of Maoism," part 1 in Against the Current, Summer 1981, esp. pp. 50-3.

it to set prices to its advantage.<sup>25</sup>

Now, my contention is that given the predominance of these bureaucratic relations of production in China, producers and bureaucratic exploiters alike, both as individu-

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<sup>25</sup> I claim no originality for the idea of a "bureaucratic" mode of production. On the contrary. The thesis that the ruling bureaucracies of the Soviet-type societies constitute a "new class," and the argument that these societies represent an historically novel mode of production, within a Marxist typology, has formed the center of an important debate within the left for half a century. The notion of the self-transformation of the Soviet bureaucracy into a new ruling class had been raised as early as 1922 by Bukharin and again by Rakovsky (then in exile) in 1929. But it was the Italian left-oppositionist, Bruno Rizzi, who first proposed the notion of "bureaucratic collectivism" and gave the idea an extensive if rather crude theoretical treatment in his La bureaucratisation du monde (1939). The concept has subsequently been restated in one or another variant forms by Max Shachtman (the "bureaucratic revolution") James Burnham (the "managerial revolution"), Milovan Djilas (the "new class"), Jacek Kuron and Karol Modzelewski (the "bureaucratic state"), and John Fantham & Moshe Machover ("state collectivism"). (See bibliography). But while the basic concept has been advanced more than once, with the partial exception of Rizzi, and Kuron and Modzelewski, little has been done to develop a coherent and empirically verifiable theory of this mode of production. I take it that such a theory would have to include, at a minimum, first, a systematic description of the defining elements of this mode of production, its classes, specification of the form and means of surplus extraction, and secondly, some specification of the central dynamics -- the contradictions between the forces and relations of production, historical tendencies or "laws of motion" of this form of society. Such a project is far beyond the scope of the this work. Nevertheless, an important aim of the present chapter is to present certain essential lineaments of such a theory based on the empirical evidence of the problems of bureaucratic-led development and reform in China.

als and as classes, have to adopt strategies ("rules for reproduction") with respect to the economy (as yet unspecified) that are designed to reinforce if not better their own economic positions and guarantee their social reproduction from generation to generation in their current place. Furthermore, since the choices of practicable viable strategies are sharply constrained by these preexisting social-property relations (e.g. workers are not free to quit their employer and seek better conditions elsewhere, as under capitalism), and since most of the time (i.e. except in moments of profound crisis and turmoil), it is not possible to think of overturning these property relations, producers and exploiters must therefore "work within the system" and indeed, will usually find it in their interest to try to reinforce the system.

Finally, it is my contention that the adoption of these strategies has tended to impose a rather specific pattern of economic development in China characterized in the main by slow productivity growth, development by extensive (rather than intensive) growth, overinvestment, tendencies toward redundant or duplicate investment, and tendencies toward local, regional and national autarky. These tendencies, which are also characteristic of economic development in other bureaucratic economies are, I believe, basically built-into the bureaucratic mode of production, and are generally not plastic in response to reforms, whether of the

maoist or market socialist variety. Put another way, the problems of the system are not limited as to policy and cannot be resolved by reforms. They are, on the contrary, rooted in systemic contradictions which are built-into the existing structure of power and property.

### **The Market Socialist Utopia:**

#### **"Getting the Government Out of the Economy"**

In contrast to my perspective, the underlying assumption of market socialists in China and the West has been that class and property relations are essentially irrelevant. Rather, they assumed that "the market" contains its own ineluctable logic, which tends to impose a dynamic of competition-induced efficiency and pressure to develop the forces of production, in any society, regardless of the prevailing class/property structure. It was for this reason, as noted at the outset, that such socialist-inclined professors as Mark Selden could insist that China can retain its socialist property form (state ownership of the means of production), and still use the market to rationalize the plan. It was also for this reason that theorists as ideologically disparate as Selden on the one hand, and World Bank development economists on the other, could view the overall problem of "economic irrationality" as essentially an administrative problem, a problem to be resolved by changes in government policy, viz. economic reform, instead

of, as I contend, a social problem rooted in the contradictions of the class structure of post-revolutionary China, and not significantly amenable to market reform.

The proposition that class/property relations are irrelevant to the project of economic reform has been advanced in its most explicit form by China's reformers, in their notion that China is today a "planned commodity economy." This idea, cooked up for the political leadership by China's reformer-economists to justify the market reform strategy, holds that "market forces" and "the law of value" are generally applicable in China because (pace the Gang of Four) commodity production still exists in the current stage of Chinese socialism.<sup>26</sup> They can say this because the techno-economic determinist assumption of their model is that commodity production grows directly out of the forces of production. Thus China's foremost reformer-economist Xue Muqiao writes that

like the capitalist society, we too are engaged in large-scale production, and not the natural economy of self-sufficiency. In large-scale production, the relationships between the various occupations, industries, and enterprises are extremely complex, and it could hardly be managed without market relations. Of course, capitalist market regulations involve free com-

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<sup>26</sup> "In the historical period of socialism, commodity economy cannot be done away with. On the contrary, it has to be developed to a high level as the only means to build a powerful material base for socialism." Jiang Yiwei, "Theory of an enterprise-based economy," Social Sciences in China, March 1980, p. 56.

petition, whereas our market regulation is guided by the plans. We must realize that so long as there are commodity production and commodity exchange, we cannot eliminate market regulation.

Another prominent Chinese economist, He Jianzhang, adds that "Where commodity production and exchange exist on an extensive scale, the law of value, which is the 'basic law' of commodity production, naturally operates in all circumstances."<sup>27</sup> In these formulations, it is the division of labor and the factory as a social-productive unit, which are seen to give rise to "commodity production." And commodity production imposes certain inviolable "economic laws" which are assumed to be binding upon any society based on large-scale specialized factory production, whether capitalist or socialist. This means, according to these theorists, that the specific form of ownership of the enterprise (state or private) is irrelevant to the operation of the enterprise ("operation" broadly defined to include not just internal operation but external market relation).<sup>28</sup> Thus, the "owner-

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<sup>27</sup> "Zai lun jihua yu shichang tiaojie (More on planned economy and market regulation)" Jingji Yanjiu no.6, June 1982, p. 10.

<sup>28</sup> "No matter what modes of production are adopted, the nature of the system of ownership of enterprises is, after all, not determined by the concrete mode of operation of the enterprises. The nature of the system of ownership, or the nature of the occupation of the means of production, reflects a certain economic relationship, further reflecting a certain social relationship while the mode of operation reflects only the concrete organizational form of labor. When the right of ownership of the means of production is relatively separated from the power of utiliza-

ship" and "functioning" of enterprises are seen to be distinct and separable.<sup>29</sup> It therefore follows, according to these theorists, that under socialism, although the state is "the supreme organizer" above and outside the firms and sets broad goals, the enterprise is nevertheless an independent "economic entity," a "legal person" with "rights" as well as obligations, but which "can" and indeed "must" operate according to "objective economic laws" (of commodity production).<sup>30</sup> It is on this theoretical basis that Xue and his

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tion, the process of utilizing the means of production and the concrete organizational form of labor itself do not reflect the nature of the system of ownership of the means of production. In short, the right of ownership of the means of production is one thing, and the power of utilization, or the power of operation, of the means of production is another." Shen Guoxiang, "The relationship between the right of ownership, the power of operation, and the power of management under socialist conditions," Guangming Ribao August 26, 1984 p. 1, FBIS September 7, 1984 pp. K7-8. (emphasis added).

<sup>29</sup> "In the final analysis, the social and economic nature of a country is determined by its system of ownership; the patterns of economic operation and forms of management have no real influence over its social and economic nature." Gao Shangquan, "Relations between planning and market," Beijing Review April 11-17, 1988, p. 23. Gao is Vice-Minister of the State Commission for Restructuring Economic Systems.

<sup>30</sup> Jiang Yiwei, "Theory," pp. 51, 54, 66, and this on page 63: "The state organs of political power should be separated from economic entities. The state should exercise leadership over the economic entities and supervise them from without, and should not direct their daily activities as a superstructure within them."

colleagues have maintained that if the state would just "let go" of the enterprises, "separate itself" from the management of the enterprises, then the objective laws of the market would "naturally" discipline the enterprises and correct the plan. Gorbachev's economists have recently enunciated virtually the same theory to support Soviet reforms, and presented it in almost identical terms.<sup>31</sup>

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<sup>31</sup> Thus, in his widely acclaimed new book, The Economic Challenge of Perestroika (Bloomington: Indiana University Press, 1988), Abel Aganbegyan, chief economic advisor to Gorbachev, tells us that: "The rule of commodities under capitalism, however, cannot negate the indispensable fact that commodity production and money existed before capitalism and exist under socialism as well. Commodity production and market relations arise when producers are individualised and there is a division of labour. In such conditions goods are exchanged to meet social needs." (p. 126). Under the envisioned reforms, this commodity exchange is to take place at value: "The essential attribute of a market is consumer choice. The advantage of a market is lost when monopoly occurs. To give the market its economic effectiveness, competition between producers making similar or the same goods is crucial." (p. 131). "In the market place commodities obtain the social recognition of the consumer -- they are bought or rejected. Social valuation is given to the production costs of the goods." (p. 132). Yet, it is far from clear precisely how such competition and exchange at value could possibly emerge -- since, obviously, this would require, at a minimum, free mobility of factors (means of production, labor, land, and capital) -- and yet Aganbegyan tells us that in his vision of a reformed Soviet Union, "in contrast to capitalism commodities and money relations are not universal categories. Land and natural resources cannot be bought and sold. Since there is no unemployment and the economic base of society accords with socialist ownership, there is no labour market. A market for capital is not envisaged as part of perestroika. There are no plans for a Soviet stock exchange . . . [and moreover] a socialist market is a government-regulated market. Through the prescription of set economic proportions, fixed wages and a system of state finance and credit, the monetary income of



But, of course, the problem, which can't really be wished away by such innovative theoretical abstractions, is that, if the state is to maintain ownership of the means of production, and if it is, furthermore, to carry out macro planning, to be the "surpreme organizer" in determining broad priorities, then how practically, can the state "get out of the economy?" Even if the state wished to restrict itself merely to setting broad priorities, all such broad plans necessarily require specifics -- the more so when

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the population is regulated. On the other hand, prices for most essential products are also to be set by state bodies. Major capital investment and other economic levers and stimuli are in the hands of the state and can be directed at greater or lesser production of certain goods and thus have a major influence on the market." (p. 127). But it may be asked, how could consumers have a choice, and products receive "social valuation" when prices for most essential products are still to be set by the state? How could producers "making the same goods" compete when there is no market for labor, for means of production, when land and natural resources cannot be traded on the market, when capital investment finance are still in the hands of the state? How could producers be rewarded (or penalized) for their efficiency (or inefficiency) when wages and incomes are to remain "fixed" and "regulated" by the state? In short, Aganbegyan's utopian prescription does not begin resolve the theoretical, not to speak of the practical problems of "separating operation from ownership" in the bureaucratic system. Despite the current furious enthusiasm for Aganbegyan in the West, it is (in my view) a certainty that Gorbachev will have no more success in untangling these contradictions than his Chinese counterparts.

market. If, for example, the state wishes to increase the output of electric power, or develop the communications and transportations networks (to cite three priorities that the Chinese government has actually tried to emphasize in recent years), this requires that resources be allocated for these goals. Since resources are scarce, this means that some resources must be taken away from other sectors, such as housing and hotel construction, consumer goods production and imports (to cite some categories of spending that the government has tried to restrict in recent years) that currently command high market values. So which is it to be? Which is to decide, market demand or the plan? If the market, then not the plan, and vice versa. In short, if the reformers wish to enforce even the most minimal planned priorities, they can't leave resource allocation to the anarchy of the market. Deng and Zhao understand and appreciate this, even if their economists do not. This is why, as we have seen, the center has repeatedly intervened precisely to curb the development of free markets, to restrict consumption, and to reallocate scarce resources toward its own priorities, including, among other things, energy, communications, and transport.

Now, World Bank development economists have naturally been less concerned about the theoretical contradictions of market socialism, since they have no need to reconcile advocacy of the market with socialist presuppositions. Their

approach has been largely atheoretical and pragmatic. Yet, interestingly, although the Bank understands full well that China's economy, like all centrally planned economies, operates under vastly different constraints than market economies, nevertheless the Bank assumes that China's economy can be made to work like a market/capitalist economy even though it is not based on capitalist property relations. Thus, the Bank has simply taken, as a working assumption, that the operative norms and imperatives of neoclassical economics: competition, profit maximization, specialization by comparative advantage, innovation, entrepreneurship and the like, could simply be grafted onto China's bureaucratic economy. But, in my view, this can by no means be assumed, precisely because a market dynamic requires as its prerequisite more or less fully developed capitalist property relations and is hardly conceivable without them. By contrast, the Bank has tended to assume that a market dynamic could be emulated in the Chinese context simply by relinquishing central control over much of state industry, by fostering small-scale private/cooperative and foreign industries to compete with state-owned firms, and not least, by education and the "demonstration effect of modern management techniques."<sup>32</sup> Extrapolating from "the experience of

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<sup>32</sup> See the World Bank, China: Long-Term Development Issues and Options, pp. 7-10, 164-169. Quoted passage is from p. 7.

other countries" (not identified, but presumably, capitalist countries), the Bank, in places, even suggests that decentralization in and of itself will lead to more market oriented behavior:<sup>33</sup>

Such devolution could have a number of advantages. It would give greater meaning to enterprise independence. . . It would increase the medium and long-term responsiveness of production to evolving needs and demands. It would make fuller use of the detailed knowledge of enterprise managers. It might also provide a way of strengthening incentives for sound investment decisions, in whose outcome enterprise managers could be given a direct personal interest. Experience suggests that this would encourage bold and innovative thinking combined with a thorough analysis, hard-headed calculation, and the avoidance of waste.

From the Bank's perspective, the virtual monopoly of state ownership in the industrial economy was seen as an important but not insurmountable barrier to fostering such a competitive dynamic. The Bank suggested that perhaps the best way around the problem was to give strategic decision-making authority in the enterprises over to boards of directors comprised of "institutions with a strong interest in the firm's profits." "This would be the case, for example, if the institutions were owners entitled to dispose of the enterprise's after-tax profits, either by reinvesting them . . . or by withdrawing them for consumption or investment elsewhere. The board could then insist that the enterprise's

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<sup>33</sup> Ibid., p 13.

managers behaved appropriately, partly by its authority to appoint and dismiss them, partly by linking their remuneration to profitability."<sup>34</sup> True, the Bank did concede that such a classically capitalist solution might be meaningless in an economy where state ownership of the means of production predominates:<sup>35</sup>

Experience elsewhere makes it clear that merely establishing boards of directors for state enterprises is not enough. What is necessary, in addition, is that these boards should not be just profit-oriented, but also free from direct intervention by state administrative organs. However, precisely because these are state enterprises, this may be difficult to achieve. Even if an enterprise's board of directors were to consist of representatives of the Ministry of Finance or a new Ministry of State Property, rather than representatives of the relevant sectoral ministry or the government of the locality where the enterprise is situated, informal connections and pressures could effectively perpetuate direct government control of the enterprise.

Yet, nonetheless, the Bank suggests that "a possible solution" might be to "to spread the ownership of each state enterprise among several different institutions, each in some way representing the whole people, but with an interest mainly in the enterprise's profits rather than directly in its output, purchases, or employment." In China, the Bank suggests, such a system of socialist joint stock ownership could perhaps be created by "dispersion of the ownership

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<sup>34</sup> Ibid., p. 165.

<sup>35</sup> Ibid., p. 166 (emphasis added).

capital of existing state enterprises," by letting state firms buy up each other's stock, or by placing the stock in the hands of large holding companies.<sup>36</sup> But, of course, such reorganizations have been tried before, in Eastern Europe and the Soviet Union, and the result has been simply, in the Bank's own words, "to substitute one form of bureaucratic intervention for another."<sup>37</sup> Yet the Bank chooses to ignore its own conclusion. In so doing, the Bank is unconsciously smuggling back into its recommendations for China, the operational assumptions of capitalism, which are irrelevant and moreover, positively misleading.

The World Bank is, in my view, absolutely right to insist that the key to making management more market oriented is in vesting control over management in the hands of "profit minded owners." But this is only an implicit recognition that (pace Xue Muqiao and his colleagues) enterprise "operation" is not, in fact, "separable" from "ownership," as market socialists (including those at the World Bank) have assumed. On the contrary, it is precisely the form of ownership that is the all-important determinant of

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<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

enterprise behavior. More precisely, it is the specific property form, or surplus extraction relations of capitalism, that give the market its force and potential, as I tried to indicate above. But this just means that if China's ruling bureaucracy is unwilling to turn over control of state industry to such profit minded owners who are not, in the last analysis, just another organ of the state, then it is difficult to see how the reformers can avoid repeating the East European experience of simply replacing one form of state intervention with another.

This means that from the start, market socialists face intractable theoretical and practical contradictions: First, there is no way the market can rationalize the economy unless the state literally "gets out of the economy." But there is no practical way for the government to get out of the economy unless the state sells off the means of production to private owners. Moreover, were it to do so, there would be nothing left to plan, hence no "socialist" aspect of market socialism -- because what would result would be capitalism. This is, in my view, the root contradiction of market socialist theory and strategy. The continued predominance of state ownership of the means of production has always been the fundamental assumption of market socialists in China and the West, the starting point of market socialist theory -- and yet, this is the main barrier to the operation of the market.

### III. THE CONTRADICTIONS OF BUREAUCRATIC-LED DEVELOPMENT AND REFORM

The problem can be seen as follows. To get the sort of competition-induced efficiencies the market reformers want, it is not enough merely to offer management and labor all carrot and no stick. As the reformers themselves have lately come to realize, it also requires objective market pressures, viz. real competition, to compel the firms to cut costs and become more efficient producers. But for such pressures to be real, the firms must be faced with the threat of extinction, i.e. bankruptcy and layoffs, viz. economic losses for the owners and unemployment for the managers and workers, as the penalty for unsuccessful competition. In the words of the CESRRI analysts: "A prerequisite of containing the expansion of consumption funds is the unemployment of some workers. Similarly, the prerequisite to quenching the 'thirst for investment' is the bankruptcy of some enterprises."<sup>38</sup> But for this threat to be real, it must

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<sup>38</sup> Reynolds, Reform in China, p. 19; also pp. 25 and 143. Speaking of the need to "deepen reform," Zhao Ziyang has called attention to the fact that "Under the new economic structure, the survival and growth of an enterprise and the increase of material benefits for its workers . . . will be largely dependent on the successful management and operation of the enterprise itself. This will put all enterprises and their directors to a severe test. As we failed to place sufficient stress on this in the past, some people misunderstood reform to mean merely delegating more decision-making power to enterprises, reducing their taxes and allowing them to retain more profits. Now that we have begun to implement the reform in a comprehensive



be possible, first, for the owners of the firms to withdraw their investments from unprofitable firms or unprofitable lines of production, and shift their investments into more profitable firms, or into more profitable lines of production. Secondly and equally, to compel workers to produce more efficiently, it must be possible for the owners/managers to fire inefficient workers, and to replace them, at will.<sup>39</sup> In short, the indispensable prerequisites of market driven competition are the predominance of free labor and free capital, viz. capitalist property or class relations.

### III. A. The Bureaucratic Property Form, Ruling Class Reproduction, and the Primacy of the Bureaucratic Plan

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some people misunderstood reform to mean merely delegating more decision-making power to enterprises, reducing their taxes and allowing them to retain more profits. Now that we have begun to implement the reform in a comprehensive way, all enterprises must have a stronger sense of the need to improve product quality and economic efficiency [and] meet the demands of the market . . . If they do otherwise, they will lag behind the reform and eventually become obsolete." "Report on the Seventh Five-Year Plan," Beijing Review, April 21, 1986, pp. XV-XVI.

<sup>39</sup> See the World Bank's discussion of these two points in China: Long-Term Development Issues and Options, p. 10 and 12.

But in China, the bureaucracy cannot elicit such a market dynamic because it cannot dispense with planning and free up the factors of production, precisely because maintenance of the plan and direct control over the factors of production are essential to ruling class subsistence and reproduction. To the extent that the bureaucracy were to give up direct control over the factors of production to other social classes (e.g. capitalists), to this extent it would be cutting itself out of the economy, and thereby, threatening its own survival. Furthermore, the bureaucracy cannot even really give its own enterprises much control over their own surpluses -- to invest these and to distribute them as wages and profits to management and workers, because, again, to the extent that they do so, they would lose control over the firms, and thereby the economy. This is why even the most radical of China's reformers have insisted that the government has no intention of subordinating the plan to the market. On this score, the reformer-economist Xue Muqiao aptly summed up leadership thinking in the formula: "large-scale planning, small-scale freedoms" (da jihua, xiaoziyou).<sup>40</sup> The reformers have always been vague about just what these "small freedoms" amount to --

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<sup>40</sup> "And inquiry into the question of reforming the economic system," op. cit., p. 5.

precisely because they wish to reserve the right to intervene, if necessary, in virtually every aspect of the economy so as to ensure that the bureaucratic plan is fulfilled, and, as we noted, they regularly do so.

Thus the predominance of bureaucratic class relations has thrown huge, and in most cases, insurmountable obstacles in the way of introducing market pressures to reform the economy. I want to explore several of these below.

### **1. Systemic Barriers to Competition**

Let's first consider the problem of eliciting competition in the context of bureaucratic property relations. The reformers goal has been to promote competition between firms, in order to force the firms to increase productivity. Under capitalism, competition results from the struggle of individual firms to hold onto or increase their share of the market. To do so, firms must produce at least as efficiently as their competitors. The capitalist owners of the firms can force their firms to compete effectively, because, if they do not do so (as the World Bank reminds us), these "profit minded owners" are free to withdraw their investments from uncompetitive firms and reinvest them in more profitable ventures elsewhere in the national, or even the international economy.

#### **"One Colossal Enterprise"**

However in China, the bureaucracy cannot do this. In China, the bureaucracy's economic base is limited to its own

national economy -- but it owns virtually every significant industrial enterprise in that economy.<sup>41</sup> Thus, China's econ

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<sup>41</sup> It may be objected that this is an oversimplification, since not all industries are owned by the state. First, there are the rural private enterprises discussed above in chapter two which are entirely outside the state planned economy. These are significant and growing, but as yet pose no competition for the state sector. With respect to the urban industrial sector proper, only a miniscule part of the urban industrial economy is really outside the state planned sector. Officially, the Chinese divide the urban industrial economy into three main branches: state owned, collectively owned, and a third category comprised of individually owned and "other economic forms" (mainly small private employers, almost all of whom are in the retail trades, restaurants and other services industries). In 1985, the state-owned sector accounted for 70.4% of gross value of industrial output (GVIO). The collective sector accounted for 27.7%, and "individual and other" accounted for a combined total of 1.9% of gross output value. Of the total of 123.6 million urban workers in 1985, 89.9 million were employed in state owned sector, 33.2 million were employed by urban collectives, and some 450,000 were self-employed. Statistical Yearbook of China 1986, pp. 92, 224. In reality, however, only the self-employed individuals (whose output accounts for 0.4% of GVIO) and probably most of the "other" (which accounts for 1.5% of GVIO), fall completely outside of the state planned sector. Most so-called collectively owned industries, though some were originally owned by their employees, have long since been subsumed under state ownership (normally, these are said to be owned by local governments), and their employees are, actually if not formally, state employees. Like all state industries, urban collective industries receive production assignments and performance targets. Their output is bought up by the state or its agents. Their workers are subject to compulsory job assignment by the state. Investments are funded by ministerial or other bureaucratic system allocations. Profits are passed up to the state through local supervisory agents, i.e. local governments, and losses are covered by the responsible ministries or systems. Christine P.W. Wong, "Ownership and control in Chinese industry: the Maoist legacy and prospects for the 1980's," in J.E.C. China's Economy Looks Toward the Year 2000, (1986), pp. 582-88. Moreover, the original idea that worker-owners shared their enterprise's income has long

omy, or at least its industrial economy, is best understood

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been superseded by the payment of ordinary wages. The applicable scales are not centrally prescribed, but the must be approved by local (state) labor bureaus and have ususally been related to, although somewhat below, those in state owned industry. World Bank, China: Socialist Economic Development, Vol. 1. p. 61. Professor Wong hypothesizes that the distinction between "state" and "collective" enterprises has been maintained to distinguish enterprises financed "internally," i.e. out of local accumulation, from those financed by central state budgetary allocations. This is important because, as Wong points out: "for national accounting purposes, 'ownership' in the state sector is defined by the claim on remitted profits: a centrally owned enterprise remits its profits directly into the central budget, a provincial enterprise remits its profits to the provincial budget, etc. By this criterion, only 3% of the 83,000 state-owned industrial enterprises were directly owned by the central government (zhongyang zhishu) in 1980. The rest belonged to local governments (difang zhishu) and remitted their profits to local government revenues." Op. cit., pp. 584-85. For the present purposes, I am mainly concerned to point out that most urban collective as well as state industry in China is the property of a single owner, the state, because in my view this fact has fundamental implications for the reformers' goal of eliciting market competition between enterprises. But with respect to the question of intrabureaucratic competition and conflict over the division of the social surplus (discussed below), the fact that this state "ownership" resides at the central, provincial, prefectural, county and municipal levels, has important implications. Most crucially, because most profits of industries are remitted upward to their respective "owners," there is tremendous bureaucratic competition -- both horizontal (between localities, ministries, and departments), and vertical (between the upper and lower levels of government) -- to acquire possession of enterprises. See Wong, op. cit., p. 584, and below. For a historical overview of the development of collective industry, see Jianzhong Tang and Laurence J.C. Ma, "Evolution of urban collective enterprises in China." China Quarterly, pp. 614-40.

as if it were a single gigantic "firm" -- "China, Incorporated," with a single owner, the state (the bureaucracy).<sup>42</sup> Because the ruling bureaucracy possesses a near monopoly of industrial ownership, and because it owns these enterprises collectively, this poses formidable barriers to the project of eliciting market competition between firms.

First, the bureaucratic owners cannot really play off one enterprise against another, cannot penalize the inefficient by letting the efficient firms drive the others "out of business." Why? Because from the standpoint of surplus extraction, the bureaucracy constitutes a single collective class, a single "owner." Since this single "investor" owns all the firms, the efficient and inefficient alike, a gain by one firm at the expense of a competitor is simultaneously a loss for this same investor. Under capitalism, of course, such a situation is unlikely to arise, since even the largest individual capitals own only a small fraction of the whole national economy. Under capitalism, subsidiaries of corporations do not, really, compete against other subsidiaries of the same corporation; they compete against other corporations. Thus, to take an example, Oldsmobile

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<sup>42</sup> See again, chapter one pages 35-36 for Jiang Yiwei's very apt description.

does not really compete against Buick (even though both are in the same class), since, obviously, a gain in market share by one at the expense of the other would be meaningless to their owner, General Motors. In reality, they both compete against Ford, Chrysler, Honda and other producers. But most importantly, should one division, say Buick, regularly fail to be profitable, GM is free to, and would most likely be obliged by its shareholders, to sell off the non-performer (normally, to other capitalists).<sup>43</sup> But in China, this strategy is not available to the bureaucratic owners. Who could the state (the bureaucracy) sell its inefficient industries to? Members of the ruling class can't sell off unprofitable firms to each other, as capitalists do, because they do not own their "capital" individually, but collectively. Nor can the bureaucratic divisions, e.g. ministries, departments, local governments, sell off their inefficient firms to other firms or to other ministries (as the World Bank recommends), because, it should be obvious, to do so

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<sup>43</sup> The foregoing scenario is, of course, somewhat of an oversimplification, since there are many instances in which subdivisions of corporations are regularly compelled to compete against each other, even when they do not, as in the example of autos, produce the same product. Subsidiaries may still be pressured by their owners to meet or beat the sales or profitability targets of other divisions. But they can only be compelled to compete in this way, because they exist in an environment in which subsidiaries can, and regularly are, sold off for failing to make the grade.

would just be taking money out of one pocket to put it into another. Nor again, generally speaking, can the bureaucracy overcome the problem of low profits at home by shifting its capital outside the national economy -- by investing in Taiwan, or Singapore, or Brazil or South Africa, as Western capitalists do. As it happens, the Chinese government and its subsidiary units have made substantial foreign investments, but while these may be profitable, they do nothing to improve economic performance at home, and meanwhile of course the government cannot get its capital out of its inefficient industries at home, in China. This leaves the bureaucracy with two hypothetical alternatives. They could sell their industries to foreign capitalists (possible, but unlikely -- for the reasons stated above). Or, they could sell them to the workers.

#### **Stock Markets with Chinese Characteristics**

Now some Western analysts evidently think that this last option is the wave of the future, since a few firms have recently been permitted to sell so-called "stock shares" to their workers, and in Shanghai and other cities, so-called "stock exchanges" have opened up in recent years. But these, as with so many other "market" reforms in China, turn out to be the form without the content, intended in large part for the benefit of delegations of Western bankers and Wall Street brokers. One such delegate, visiting the newly opened stock exchange in the industrial city of



Shenyang, took note of her hosts's efforts to give the premisses the flavor of a real exchange -- down to the installation of an ersatz "Big Board" and a wall-sized photographic mural of the New York financial district.

But:<sup>44</sup>

As it soon became clear, Chinese stock markets are, in Western terms, a misnomer. The exchanges are controlled by the People's Bank of China. Most of the securities are in fact bonds. Even the two so-called stocks on the Big Board in Shenyang, for example, do not represent a pure equity stake in the issuing companies. They are somewhat of a hybrid, with some features of bonds (guaranteed principal and nominal interest rate) and some of stocks (a year-end dividend based on profitability). Typically, they mature in five years; interest plus dividends may yield 15 percent a year or more.

Trading in these securities is virtually nonexistent. There is very little incentive to sell: Price movement is slight, and the overall returns on these scarce securities far surpass the 7.2 percent interest rate on bank certificates of deposit."

In reality, it seems that the main purpose of such "stock" issuances in recent years has been for firms to raise extra capital for expansion, by attracting worker savings, by offering higher interest rates than the banks. The reformers also hope that workers, by buying a share in their enterprise, will become more concerned about the firm's efficiency, and therefore work harder. But even

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<sup>44</sup> Nancy Dunnan, "Yuan to invest," New York Times Magazine, November 29, 1987, pp. 28, 34; quoted passage is from p. 28.

though such bonds can't legally be traded, and can't change in value (and so can hardly influence, or be influenced by enterprise performance), still, the reformers evidently wish to make sure that the workers do not gain even nominal control of state firms, by insisting that the state retain a 70% stake in state-owned concerns.<sup>45</sup> The bureaucracy's intuitive caution is understandable, for it is difficult to see how the reformers could carry this very far, since in selling off any substantial part of the industrial economy to workers, or anyone else, the bureaucracy would be, in effect, cutting itself out of the economy and handing real economic power over to another class -- which would be tantamount to inviting its own self-destruction.

Since the ruling class cannot, as a practical matter, force its enterprises to greater efficiencies by the threat to sell them off, this has, to my mind, at least two critical implications for economic development and the project of reform. First, since the bureaucracy cannot sell off its inefficient enterprises, it has little choice but to try to

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<sup>45</sup> Victor Fung, "China's State-owned firms issuing stock," Wall Street Journal, March 18, 1986. See also, Adi Ignatius, "China stock owners aren't exactly sure what stock is for," Wall Street Journal, February 9, 1988; and Tom Engle, "Stocks: new domestic financial tool," The China Business Review, January-February 1986, pp. 35-8. For the official Chinese version, see the articles in the Beijing Review of December 29, 1986, October 5, 1987, and February 1-7, 1988.

keep every firm operating, no matter how inefficient. So it must strive to increase the output of the economy as a whole (rather than play off one firm against another). We can understand why this becomes imperative, if we imagine for the moment a situation in which, say, the Buick division of General Motors regularly failed to make sufficient profits -- but for some reason GM was prohibited from selling off the division and was also compelled to continue paying the Buick workers their wages. Under these conditions, GM would likely lose less money by continuing to produce Buicks at a loss, because it would lose even more money if the plant and workers were idled. In the former case (continued production), Buick would incur only the additional cost of raw materials, but would accrue what profits there were from sales. In the latter case (a shut down), it would still have to pay out wages and maintenance for the upkeep of factory and distribution facilities, but would receive no return from sales. This is, roughly speaking, the predicament of the Chinese bureaucracy. Since they cannot sell off their inefficient firms, it pays to try to keep as many firms operating as possible, since if the plant and workers were idled, total national output would fall, and this would mean less surplus available for accumulation and consumption. Thus the bureaucracy tends to see it in its interest to keep as many firms operating as possible, regardless of efficiency. This is, in my view, the reason why moves toward

instituting bankruptcy are perpetually postponed, and not because the reformers lack the "will" or because they need to introduce price reform first.

### **Price Reform in the Context of Immobilized Factors of Production**

Now many Western analysts have assumed that a move toward true competition will develop as soon as the government institutes price reforms, which are (always) only beginning to be implemented. According to this view, the problem is that industrial and fiscal decentralization were carried out in the context of a highly irrational price structure, i.e. a structure in state-set prices that do not correspond to real demand and supply. In this situation, it was a foregone conclusion that decentralization would only lead to another round of irrational investments.<sup>46</sup> Presumably therefore, when prices are reformed (either adjusted to bring them more in line with world levels, or, in the more extreme proposals, freed to rise and fall according to supply and demand), profit rates will tend to

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<sup>46</sup> See e.g. Susan L. Shirk and James B. Stepanek, "The problem of partial reform," China Business Review (November-December, 1983), pp. 8-9; and Robert F. Dernberger, "The Chinese search for self-sustained growth in the 1980's: and assessment," in the Joint Economic Committee of Congress, China Under the Four Modernizations (Washington D.C.: U.S. Government Printing Office, 1982), pp. 67-72.

even out, producers will compete on a more even basis, and production will respond to consumer demand, instead of the rigidities of the plan.

But, to begin with, price reform would be meaningless unless the bureaucracy also relinquishes control of the allocation of the factors of production (labor, means of production, capital and land) and also relinquishes control of the distribution (sales) of finished products. For, again, without full mobility of factors, how could prices possibly respond to supply and demand? For example, prices in Hungary are more "rational" in the sense that (unlike those in China) they fairly closely approximate world market prices, but economic irrationality is no less a problem in Hungary than in China. This is because, although Hungarian reformers abolished the centralized command planning system in one stroke (on January 1, 1968), the ruling bureaucracy still refused to "let go" of the economy. The bureaucracy gave up direct macromangement of the economy -- only to replace it with so many levers of indirect control, that, as Janos Kornai puts it, "millions of detailed interventions have become the rule."<sup>47</sup> As a result, prices still do not reflect scarcity, costs still do not discipline the firms,

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<sup>47</sup> "The dual dependence of the state-owned firm in Hungary," in Tidrick and Chen, China's Industrial Reform, pp. 317-38; quoted remarks are from p. 320.

and today, Hungary's "reformed" economy is the very exemplification of the "soft budget" problem.

China's reformer-bureaucrats face the same dilemma. For, how can the bureaucracy relinquish controls over allocation and distribution without giving up its ability to plan the economy, which is, as I've tried to demonstrate, indispensable for its own reproduction? Historically, as we've seen, at every single point when the economy threatened to get "out of control" (viz. market forces actually began to exert some effect) the bureaucracy, led by the reformers, intervened to reassert control over the economy, recentralizing factor allocation, investments, prices, wages, trade, etc. precisely so as to be able to enforce the bureaucratic plan.<sup>48</sup> It is not price reform which is holding up economic rationalization, but rather it is the bureaucracy's overriding concern to enforce the plan, and to keep every firm operating to meet the goals of the plan,

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<sup>48</sup> Thus one also finds, almost invariably, that every call for reform is hedged by an insistence on the immediate "temporary" need for centralization. Even the CESSRI team write that: "Reform today is faced with grave challenges. We must pluck up our courage and with 'opening up' as our watchword, prudently handle the two challenges of structural wage inflation and 'thirst for investment,' by opening the labor and financial markets. . . [But] to guarantee the smooth fulfillment of the two tasks mentioned above, it is necessary, for a certain period, to continue and even intensify administrative control over aggregate wages, credit, and loans." Reynolds, Reform in China, p. 27 (emphasis added).

that explains why the reformers keep postponing price reforms, or, when they do introduce price reforms, they do so in conjunction with subsidies to the losers so that no one fails, thus negating the economic force of reforms.

#### **Penalizing Inefficiency: Who Pays the Cost?**

Secondly, since the bureaucracy cannot effectively use market pressures to discipline the state enterprises, it has sought to wield a variety of other pseudo-market "economic levers" to force the enterprises to economize resources and adopt efficiencies. Over the past decade, the reformers have experimented with various tax schemes, channeling investment funds through bank loans, imposing charges for excessive consumption of fixed and variable capital, and threatening laggard enterprises with bankruptcy. But in the end, none of these strategies succeeded because they all conflicted with the bureaucracy's overriding concern to enforce the plan, and to keep its firms in operation. As we saw in chapter three, if the state wished to carry on planned production, it really had no choice but to loan the firms the necessary funds, so the banks were ultimately powerless to refuse demands for loans. Similarly, if the state wished to keep its firms in operation, it could not levy taxes and fines that would seriously imperil reproduction. So in practice, state enterprises were permitted to deduct the costs of penalties from their before-tax profits -- with the result that the state only penalized itself.

The reformers ran up against the same sort of contradiction in their efforts to elicit price competition between state owned firms, by permitting the firms to sell their over-quota output on the free market, with some price flexibility. Thus the World Bank/CASS analysts found that it was often in the interest of individual enterprises to cut or hike the prices of their products, to gain a greater market share or to increase their profits.<sup>49</sup> But since the gains in sales (e.g. through price cutting) by one state owned enterprise are offset by losses in sales for the competing enterprise, which is also owned by the state, this basically just amounts to a redistribution of profits within the same "firm."<sup>50</sup> Perhaps, because this is intuitively

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<sup>49</sup> See Tidrick and Chen, China's Industrial Reform, pp. 264, and 273 note 29, for some examples, and note 30 for some counterexamples -- where state agencies refused permission for buyers to purchase from the lowest price producers.

<sup>50</sup> World Bank economist William Byrd point out that "lower prices [for producer goods] do not mean automatic losses for the government, because if sales go to other state enterprises, lower profits for producers should be offset by higher profits for users or lower costs of investment goods (paid for by the budget)." Ibid., p. 264. But, perforce, the converse is also true, viz. raising prices, to increase profits, does not automatically mean gains for the state, because these will be offset by higher costs incurred by the buyers of producer goods -- which again, are paid for out of the state budget. So, either way, there's just redistribution, i.e. a zero sum game.



understood, the state has tried to restrict such flexible pricing, and in particular, to limit price rises to 20% above the official price, the latter because even if the enterprises are willing to pay higher negotiated prices, this is ultimately paid for by the state through reduced profits and state revenues (besides which, it contributes to inflation).<sup>51</sup> But, even more importantly, because the existence of the two-tiered pricing created a strong incentive to divert output from low-priced, within-plan channels to sales outside the plan at higher prices, the reformers have been forced to retreat on price reform, and to reimpose price controls, in order to insure fulfillment of planned production.<sup>52</sup> Thus, World Bank economist Gene Tidrick concludes that<sup>53</sup>

In summary, the Chinese system of multiple prices and multiple sources of supply has enhanced the flexibility of supply, but at high cost. It has also increased enterprise autonomy and weakened central control over resource allocation -- without, however, providing an effective alternative market-control mechanism.

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<sup>51</sup> Ibid., p. 193.

<sup>52</sup> See ibid., pp. 200-01, 207, and 262, for discussion of the problems which have arisen with the institution of multiple pricing.

<sup>53</sup> Ibid., p. 201.

### **Bankruptcies with Chinese Characteristics**

The barriers that bureaucratic property relations pose to market reforms are perhaps no more clearly illustrated than in the one instance in which the reformers actually attempted to impose the ultimate "capitalist" sanction -- bankruptcy. For years, the reformers said that they could not permit bankruptcies because they had no bankruptcy "law." Then, after numerous delays and drafts, they finally promulgated such a law in December 1986. In August of that year (note, even before the "necessary" law was enacted), the leadership announced with great fanfare that it was taking the "experimental" step of declaring one particularly poorly performing state enterprise bankrupt, the Shenyang Explosion Prevention Equipment Factory.<sup>54</sup> But once again, this "trial" seemed to be more for the benefit of Western observers, than for the effect it had on the Chinese economy. First, it is difficult to know exactly what the notion of bankruptcy could mean in the Chinese context, and in particular, who was being penalized, since the end result of this insolvency was that this state owned firm was simply

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<sup>54</sup> For the story and subsequent developments, see Victor Fung, "China's first bankruptcy tests reforms," Asian Wall Street Journal July 30, 1986; Ellen Salem, "Insolvency and the state," Far Eastern Economic Review, January 8, 1987, pp. 48-9; Ta-kung Chang, "The East is red," The China Business Review, March-April 1987, pp. 42-45.

"taken over" by another state owned firm (a local gas-supply company), and the workers continued to be paid unemployment benefits in the interim (by the state). So (state planned) output was lost while the firm was idled, and in the meantime the state still had to pay the workers. In the end, it was not so much the firm which was penalized, as the state which lost, doubly. The CESRRI analysts are, in my view, quite correct when they write that:<sup>55</sup>

In China today, if a factory closes down, all its people, from the director down to the workers, will continue to draw the same pay as usual from the factory, and all of them will be transferred to other enterprises by departments concerned. Such a 'close down' will not impose a true penalty on the bankrupt factory. No one will be held responsible for the bankruptcy. Rather, the punishment will fall on society at large or on other enterprises.

Evidently, the lesson of the Shenyang experience was learned -- by the state, and the experiment has apparently not been repeated. The government gave six other enterprises in the same city warning notices of impending bankruptcy. "All but the explosion-proof equipment factory have returned to profitability, thanks largely to the government, which provided cut-rate loans and tax breaks and helped recruit technicians to develop new products."<sup>56</sup> By the spring of

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<sup>55</sup> Reynolds, Reform in China, p. 157.

<sup>56</sup> Adi Ignatius, "As factory's forced bankruptcy shows, China won't easily accept insolvencies," Wall Street Journal, April 15, 1988. (emphasis added).

1989, the government conceded that 20 percent of state owned industries are effectively broke, and another 30 percent "have only been kept going by regular infusions of government bank loans."<sup>57</sup> What else can the state do, but continue to bail them out? The bureaucracy couldn't possibly afford the huge loss of production such across-the-board application of the law would entail (the little Shenyang factory had only 70 some employees). And, in any case, as the reformers themselves readily concede, in many cases the failure to make a profit is the fault neither of management nor labor, but of objective conditions (irrational prices, lack of access to markets, etc.) largely beyond their control. In this situation, fair competition is hardly possible, and so "enterprise responsibility" is meaningless. Given this circumstance, it was not surprising that after promulgating the law with much hoopla, the reformers shortly thereafter announced that they would withhold implementation of the law, until the leadership could resolve the dilemma over which should come first, bankruptcies or price reform.<sup>58</sup>

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<sup>57</sup> Guangming Ribao, March 11, 1989, p. 3.

<sup>58</sup> See James R. Schiffman, "Bankruptcy issue heating up in China," The Asian Wall Street Journal, August 13, 1986; and Ellen Salem, "Insolvency," op. cit., for discussion of the leadership divisions on this point.

In the last analysis, the strategy of introducing capitalist-type competition, "economic levers," the threat of bankruptcy, and so forth failed because such a capital logic only works in the context of a true market. This is only another example of how the market socialist project has been fundamentally misconceived from the start: Chinese and Western market reformers have acted on the assumption that China's banks, government tax agencies, and enterprises are independent and autonomous entities, as in capitalist economies -- even though both fully understood that this is not true. In reality, these institutions are not only organically tied to the state but also subordinate to the state plan, the instrument of bureaucratic reproduction. In a system in which the state owns all or nearly all the enterprises and all the banks, how can the state-owned banks impose penalties? In such a system, interest, capital charges, fines, and all such penalties become meaningless. These are simply paid by the state to the state. If an enterprise refused to repay its loans or fines, as many have done, what can the banks do -- attach their assets, force the enterprise into bankruptcy? To ask the question is to answer it. It is not a question of the "need to strengthen the emerging banking

system" as some Western China experts think.<sup>59</sup> Such reforms invariably end up in failure because the reformer-bureaucrats have no intention of imposing penalties that would actually threaten to close down their enterprises.

## 2. Systemic Barriers to Raising Labor Productivity

Let's now consider the problems bureaucratic property relations pose for the reformers' strategy of using market forces to discipline the workforce and boost labor productivity. In the beginning, reformers looked to economic incentives to boost enterprise productivity. But in recent years, Chinese and Western market reformers have suggested that, to be effective, these need to be coupled with the threat of bankruptcy and unemployment.<sup>60</sup> Thus the CESRRI research group conclude that<sup>61</sup>

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<sup>59</sup> This is argued, for example, by Daniel Brotman, "Reforming the domestic banking system," The China Business Review, March-April 1985, pp. 17-23.

<sup>60</sup> In the inimitable phraseology of the World Bank: "Positive incentives that kindle enthusiasm for work and reward diligence are essential. But it is vital to complement them with the threat of dismissal for poor (and not merely atrocious) performance." China: Long-Term Development Issues and Options, p. 132.

<sup>61</sup> Reynolds, ed., Reform in China, p. 107. For further discussion of this point see also pp. 19-22, 143-44, 152-53, and 159.

particularly since the peaking of the consumption fund expansion since the end of 1984, the comrades studying reforms have increasingly come to emphasize the importance of establishing an enterprise bankruptcy system. But without employment reform paving the way and specifically without a change from "employment guarantee" to "unemployment compensation," the "bowl" is still an "iron bowl," and it is still impossible to smash the "big public pot." When workers can never be permitted to lose their jobs, there is no way to make the enterprise face a real risk of bankruptcy.

To get discipline, the reformers assert, it will be necessary to take a hard line: "The single most powerful antidote to the 'upward emulation' disease [viz. workers' demands for higher pay] is the employer's ability to say: 'You are free to leave this job and compete for another with higher pay.'" <sup>62</sup>

Some reformers have suggested that China's managers ought to employ the capitalist strategem of playing off workers against each other by creating a "reserve army of the unemployed" to force the employed to work harder by the threat to fire them, as is done under capitalism. Chinese officials concede that there is massive "on-the-job unemployment" in industry and estimate that perhaps as much as one-third of China's rural workforce is

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<sup>62</sup> Ibid., p. 20.

redundant.<sup>63</sup> So the staff of the CESSRI suggest that "we must utilize our 'unlimited supply of labor' (an advantage unavailable to the Eastern European countries in their reform drive), by prudently and gradually breaking down barriers to job mobility, encouraging a flow of workers between different ownership systems and between cities and rural areas, and, in general allowing the surplus labor force to enter into employment competition."<sup>64</sup> In the words of Harvard economist, Dwight H. Perkins, "There are hundreds of millions of peasants most of whom would gladly trade places with urban factory workers if given the opportunity. If labor discipline got out of hand, a decision could be made to do just just that. Even the threat might be enough to get urban labor back to work."<sup>65</sup>

But the obvious question, then, is why don't they do it? Labor discipline in Chinese industry has been "out of hand" for decades, and yet the reform leadership still

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<sup>63</sup> See Song Linfei, "Village labor surplus and its outlet," Chinese Social Science, no. 5 (1982), pp. 121-33; and the World Bank, China: Long-Term Development Issues and Options, pp. 127 and 129-30.

<sup>64</sup> Reynolds, ed., Reform in China, p. 19. See also p. 22.

<sup>65</sup> Perkins, China: Asia's Next Economic Giant?, (Seattle: University of Washington Press, 1986), p. 47.



refuses to take up this seemingly obvious strategem. Why not?

The answer is, again, quite simple: China's factory managers, and their superior authorities, are bureaucrats and not capitalists. To create a reserve army of the unemployed, the state would have to idle (through dismissals or layoffs) significant numbers of workers. But in so doing it would run up against the same contradiction it faces with respect to idling inefficient factories -- namely, that this could only result in even greater losses for the bureaucracy. And for the same reason: that even underemployed workers produce more than their cost of subsistence. So if they are taken out of work altogether, total national output unavoidably falls.

Of course, total national output is not a concern for capitalists, for instance in the U.S., because each corporation owns only a fraction of the economy, so it need only be concerned that its own workers are working productively. If General Motors fires or lays off some workers, (a) their lost output is made up by replacing them from the local pool of the unemployed, or, what amounts to the same thing, by opening new plants elsewhere; and (b) those laid off cease to be a cost to GM, because under capitalism the unemployed must fend for themselves, or if there is unemployment compensation, this is provided by the state, so they become a burden to the state, not GM.

But in China, because the ruling bureaucracy owns virtually all significant industrial firms, and therefore employs directly or indirectly, virtually all the industrial workers, it has little choice but to strive to keep all of its employees working, regardless of their efficiency (just as it must strive to keep all of its within-plan firms operating, regardless of efficiency), or total national output would fall.

Furthermore, unless idled workers are to be thrown out in the streets to starve, the state (through its departments and enterprises) still has to provide for their subsistence, which it does -- but gets nothing in return.<sup>66</sup> World Bank economists have suggested that China's reformers could promote free hiring and firing at the enterprise level by "establishing a system of unemployment insurance and transferring much responsibility for housing, pensions, and social services from enterprises to the Government."<sup>67</sup> The assumption here is that

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<sup>66</sup> Recall, for example, that Chongqing Clock and Watch Company, for example, was obliged by the government to continue to pay its superfluous workers while they were put on "study leave" -- to the detriment of its profit picture. William Byrd et. al., Recent Chinese Economic Reforms, pp. 18,20,27 & 63.

<sup>67</sup> China: Long-Term Development Issues and Options, p. 133 (emphasis added). Also Reynolds, ed., Reform in China, p. 21.

this would relieve the enterprise of the burden of supporting unproductive workers. But this is, again, to make the mistake of viewing China's "firms" as if they were independent capitalist entities. The problem is that while this would relieve the enterprise of substantial costs, it would not relieve the owner of the enterprise, the state, from these costs. As one Beijing official put it, in China, "a worker can be fired from a workshop but not from society."<sup>68</sup> This is precisely the point. Since the government is not only the owner of nearly all industrial enterprises, but also the provider of support for the unemployed, what practical difference could it make to the state-owner whether it distributes these benefits through enterprises, or through government bureaus? In short, since unemployed workers constitute a twofold economic loss for the bureaucracy, the "threat of unemployment" strategem has radically different implications under the bureaucratic mode of production than under capitalism. Thus, the bureaucracy has been extremely reluctant to carry out its threat.

So even when, as in recent years, peasant "contract" workers have been brought in from the countryside, they have been used mainly to supplement, not replace permanent

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<sup>68</sup> Quoted in Business Week, October 19, 1982 p. 33.

workers. In his pathbreaking study of Chinese industrial relations Professor Andrew Walder noted that urban industrial directors often employ "temporary workers" (mostly peasants) on a short-term basis to do jobs that "permanent workers" in the state-owned factories resist doing, such as heavy labor, construction, excavation, moving and hauling, cleaning up, etc. Given the economic pressures driving the peasants off the land, factory directors have been able to find temporaries to do this work, or do it more cheaply, because the temporaries lack state-guaranteed jobs (and therefore assured access to housing, health insurance, pensions, and many other subsidies distributed through the workplace). But it is important to add that employers have not able to use these temporaries as a threat against the permanent employed workers, to make the permanent workers work harder, work for less money, or do disagreeable tasks, because the government still will not permit employers to fire workers merely for reasons of poor performance or breaches in work discipline.<sup>69</sup>

To be sure, the reformers have attempted to introduce some changes since the early eighties. Reportedly, the system of unified assignment for unskilled youth has been

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<sup>69</sup> Walder, Communist Neo-Traditionalism: Work and Authority in Chinese Industry, (Berkeley: University of California Press, 1986), pp. 48-54, and 72-74.

dropped. Enterprises may now "examine" prospective employees assigned to them by labor bureaus. Some jobs are now advertised. And since 1984, the government has experimented with "job contracts" between enterprises and new employees, usually for three to five years, specifying mutual obligations in regard to wages, performance standards, contract renewal, and severance. Enterprises are now in theory allowed to dismiss unsatisfactory employees. But as the World Bank concludes:<sup>70</sup>

These and other reforms, though beneficial, have not basically changed the system. The unified assignment scheme is still used for virtually all those with any postsecondary training and for some skilled manual workers. Enterprises can seldom hire badly needed skilled workers from other enterprises where their skills may be less valuable; they are still obliged by the labor bureaus to accept "packages" containing both wanted and unwanted recruits; they cannot discharge redundant workers; and they have been allowed to dismiss unsatisfactory workers only in a few instances, involving extreme absenteeism or malfeasance. It appears imperative to consider further, more radical changes.

Similarly, in their case study of Chongqing Clock and Watch Company, one of China's most reformed enterprises, the economists Byrd and Tidrick concluded that:<sup>71</sup>

Labor allocation is the least reformed part of the system. Quotas largely unrelated to the production

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<sup>70</sup> China: Long-Term Development Issues and Options, p. 131.

<sup>71</sup> Reynolds, ed., Recent Chinese Economic Reforms, p. 27.

plan still limit the number of workers CCWC can hire. Lazy or inefficient workers are rarely penalized, let alone dismissed. Redundant workers cannot be laid off.

Thus despite calls for freer mobility, the reality is that in practice the reformers continue to enforce strict controls. Because the bureaucracy's need to enforce its own plan is paramount, it must retain control over allocation of essential labor, the more scarce the skill, the tighter the control.

Yet, without the stick of unemployment, the carrot of incentives has not been particularly effective either. Under capitalism, a firm striving to increase productivity might, among other things, seek to replace less productive workers with harder working, lower paid, or more highly skilled workers. But these strategies are, generally speaking, closed to would-be reformer-managers in China, again, because there is no significant labor market. In China, industrial workers are "owned" by the firm -- or more precisely -- by the state which assigns them to individual firms in accordance with its overall plan.<sup>72</sup> Highly skilled white collar technical personnel are sometimes "borrowed" by other factories, by order of superior

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<sup>72</sup> Walder presents a very systematic discussion of the dependent character of labor in China. See his Communist Neo-Traditionalism, pp. 16, and 68-71.

authorities. But such transfers are usually temporary, rarely permanent, and invariably take place between enterprises in the same ministerial subsystem.<sup>73</sup> Moreover, despite reforms that nominally granted industrial managers great latitude with respect to incomes policy, China's industrial wage system remains nearly as rigid as its labor allocation system. In the past, wage rates for all personnel were rigidly determined by central (or local) government prescribed wage scales. In recent years, piecework and bonuses have been reintroduced. But, as the World Bank observed:<sup>74</sup>

As with labor allocation, however, these reforms have not basically changed the system. Bonuses have become general wage supplements, distributed to workers and staff in almost all organizations, often with little regard to the performance of either the organization or the individuals. Managers still have little discretion regarding promotion (or demotion). Floating wages apply to a tiny minority . . . Moreover, even with floating wages, the main determinant of earnings remains the centrally prescribed wage scales, which have changed very little and are most egalitarian by the standards of most countries, especially as regards the smallness of differentials between manual workers and technical, managerial, and professional staff.

To sum up, China's industrial managers can, in general, neither fire unproductive workers nor freely hire

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<sup>73</sup> Ibid. pp. 71-72.

<sup>74</sup> China: Long-Term Development Issues and Options, p.134.

more efficient workers. They are, basically, stuck with what the state assigns them.<sup>75</sup> Moreover, since wages are largely set by the state, they are severely hampered in efforts to raise labor productivity by bargaining with workers to drive wages down, or alternatively, offering higher wages to more efficient or more highly skilled workers.

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<sup>75</sup> Of course, to say that China's bureaucracy cannot effectively use economic methods to induce or compel workers to be more productive is not to say that the bureaucracy has no capacity to discipline the workforce. Indeed (and ironically), the bureaucracy has far more for-mal power over the workers than do capitalists in the West. First, since in China the workplace unit (danwei) is also the central point for the distribution of housing, ration coupons, major consumer durables and many daily necessities, subsidized food and staple goods, as well as the delivery of major social services and health care, this means that in theory at least, management has tremendous power over the workforce through its discretionary power to allocate goods and services that workers in capitalist society obtain outside the workplace, on the market. Managers also have the power to reward favored workers with wage bonuses, promotions, monthly and year-end bonuses, and preferred job assignments. But in addition, the bureaucracy not only possesses the legal authority to expel workers from the enterprise, but even ultimately, to commit recalcitrants to labor reform camps, i.e. to prison. Yet despite this all-encompassing power over the workers, management does not seem to have been able to use it to enforce greater economic efficiency. In practice, such extreme penalties are rarely used to in cases of breaches in work discipline. It appears that nearly all expulsions have been for political and legal offenses, i.e. political dissidence or criminal behavior. For a comprehensive discussion of these aspects of labor-management relations, see again Walder, Communist Neo-Traditionalism, pp. 60, 73, 97-102.



### **The Logic of an Egalitarian Incomes Policy**

Given the immobility of labor, we can better understand why China's industrial managers persist in distributing bonuses more or less equally, and even risk breaking the law to hand out excessive bonuses. Under capitalist norms (which are imagined by the reformers to operate in China's "planned commodity economy"), such practices would naturally undermine the goals of optimizing the workforce, maximizing productivity, and increasing the rate of return. But in the bureaucratic system, given the circumstances industrial managers face, such strategems are not only rational but essential.

If management can neither hire nor fire, nor even promote and demote at will, and if it is obliged to employ whatever workers the state assigns, then, to maximize output and productivity, management has little choice but to try as best it can to elicit the cooperation and support of all the workers in the plant. Needless to say, this goal could only be undermined if management really sought to discriminate economically against some workers on the basis of their poor performance -- to pay them in accordance with "the socialist principle of payment according to work" -- as the World Bank recommends.<sup>76</sup> For, if manage-

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<sup>76</sup> China: Long-Term Issues and Options, pp. 134-35.

ment were to employ such a competitive strategy, the would-be reformer-manager would quite likely be faced with unhappy, uncooperative, and probably even less productive workers -- which, to make matters worse, given the frequency of lifetime employment in China, he or she would have to put up with for a very long time. Given the circumstances, the prudent industrial manager in China would do better to ignore the advice of the World Bank and the Western management science experts, and pursue the most rational course of action, which is to seek to maximize the incomes of all his or her employees and to distribute bonuses as evenly as possible. Evidently, most industrial managers in China intuitively understand this law of survival in the bureaucratic system, and function accordingly, and this is why they have tended to ignore the admonitions of the management science experts.

**Coerced Labor, Slow Productivity Growth,  
Extensive and Capital Intensive Development**

The bureaucracy's inability to move to freer forms of labor also has important implications with respect to the problem of productivity growth. Because, as we have seen, the bureaucracy seeks to impose a specific pattern of economic development, to shape development in crucial aspects, especially to develop specific industries and to foster self-sufficiency, it cannot let market forces dictate the allocation of labor, but must do so administra-

tively, i.e. coercively. It must assign workers to jobs according to government priorities, if necessary against their will.<sup>77</sup> But this reliance on coerced labor poses particularly difficult problems for the bureaucracy with respect to increasing labor productivity, especially by shifting to more "intensive" (nei han) methods such as improving quality, conserving resources, encouraging innovation, and so on, because all such methods require the active cooperation and creativity of the workers --

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<sup>77</sup> This is not to say that bureaucratic allocation is necessarily rational even within the framework of the bureaucracy's own priorities. For, as will be discussed below, conflicting interests within the ruling bureaucracy systematically undermine rational allocation of labor just like they work to undermine rational allocation of everything else in the system. Among other things, this results in a squandering of (sometimes expensively acquired) training. There have been innumerable complaints in the Chinese press that highly trained graduates, often trained abroad, are assigned to jobs that make little or no use of their skills. According to a recent report in the China Youth News, many of the 38 Chinese workers who received MBA degrees in the U.S. as part of the Dalian Training Center's management program say that they are using only about 30 percent of their skills because management placed them in unsuitable posts. Many want to change jobs but their work units, which contributed some \$5,400 each for their studies, do not want to let them go. One MBA complained that he has been used mostly as an interpreter when foreigners visit his factory (the factory turned down his request for a job change). Another MBA who works in a computer technology office asked to leave but was told by his superiors, "What can we do with others who want to leave if we let you go?" Beijing Review, December 28, 1987-January 3, 1988, p. 42. Graduates with advanced scientific training face similar difficulties.

which is difficult if not impossible to elicit in the context of coercion. In my view, it is precisely the bureaucracy's unavoidable reliance on coerced labor, that is at the root of China's chronic productivity problems.

Furthermore, given the bureaucracy's inability raise labor productivity and shift to more intensive methods of growth, China's planners and managers have had little choice but to continue to pursue economic development by means of extensive growth: expansion through duplication of existing production -- increasing output by adding ever more workers and equipping the workers with ever more machinery. In its 1983 survey, the World Bank mission described China's factories in the following terms:<sup>78</sup>

With few exceptions, the plants visited showed many signs of inefficient use of capital. Machinery is abundant: most plants are opulently equipped for their tasks. In many plants, a high proportion of the machinery appears to stand idle most of the time. Some is production machinery used only occasionally, or back-up capacity; some is idle because the plants have unbalanced capacities; and usually some is idle for other reasons, such as lack of orders and energy.

Yet despite this evident overcapitalization, and despite the overabundance of inexpensive labor, two years later the Bank took the Chinese to task for their continued reliance on capital intensive approaches to growth, their preference for building and importing new plants,

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<sup>78</sup> China: Socialist Economic Development, vol. 2, p. 161.

and their preference for "technological quick fixes" to productivity problems -- at the expense of working to improve the efficiency of existing facilities. The Bank reminded China's reformers that improving productivity and product quality is not just a matter of technology, because solutions are often more likely to be found in improving "work practices," conservation of raw materials, and eliciting the active contributions of workers, since much technological knowledge cannot be embodied in machines, but rather "is embodied in people." Hence, the Bank suggests, "there can be no quick technological fix to problems of high cost and low product quality. New technology improves economic results only when carefully selected and appropriately applied over a long period. Some innovations may actually increase China's production costs, especially if they substitute expensive and electricity-intensive imported machinery, such as fully automated power looms, for inexpensive and abundant labor power."<sup>79</sup>

But given the bureaucracy's reliance on extra-economic compulsion, it is precisely these qualitative and economic aspects of productivity which are the most diffi-

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<sup>79</sup> World Bank, Long-Term Development Issues and Options, chapter 7, quoted remarks are from pp. 112 and 111.

cult, if not impossible problems to overcome. China's workers have amply demonstrated that they are not much interested in boosting productivity, because they do not directly benefit from such gains, because production is for the bureaucratic plan, which they have no control over or input into (China's industrial managers are not much interested in raising productivity either -- for similar and also different reasons; see below). So the workers show little initiative. But since, for all the reasons discussed above, the bureaucracy has little power to overcome this apathy, it has little choice, therefore, but to continue to foster economic growth in the old way -- by building ever more factories, and especially by equipping its' inefficient workers with ever more capital (machinery) in the hopes that even if they work slowly, their use of advanced technology will raise productivity. Here again, such an "irrational" approach by the standards of the World Bank, is, in the context of a bureaucratic class system, the most rational and probably the only practical strategy option. Of course, this means that the long-established pattern of slow productivity growth and extensive rather than intensive growth, is likely to continue, regardless of technology acquisition.

### 3. Systemic Barriers to Specialization

Bureaucratic property relations pose no less difficult problems for the reformers efforts to promote greater specialization and division of labor. As many observers have noted, the Chinese economy pays a heavy price in terms of suboptimal scale, poor product quality, and redundancy for the bureaucracy's preference for national, ministerial, provincial, local and enterprise self-sufficiency. This has been extremely wasteful of both human and physical resources. Western advisors, the World Bank for one, have suggested that at the national level, China ought to give up some degree of self-sufficiency in return for the advantages of specialization according to its comparative advantage.<sup>80</sup> At present, China, like most other low-income countries, mainly specializes in primary product and textile exports to industrial countries, and in such services as tourism, which are exchanged for machinery and transport equipment and other manufactured goods. However, unlike most, China also has a high percentage of exports of manufactured goods, and is highly self-sufficient in machinery. China is also basically self-sufficient in agricultural products. The Bank sug-

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<sup>80</sup> China: Long-Term Development Issues and Options, chapter 6: International Economic Strategy, pp. 97-109.

gests that since China is not well-endowed with agricultural resources, and as domestic costs increase and the real prices of agricultural products on world markets continue to fall, in the long run, "China's comparative advantage may lie in becoming a net importer of agricultural products."<sup>81</sup> The Bank also thinks that, given the prevailing world division of labor in industry, China would benefit by abandoning its preference for industrial and technological self-sufficiency. For example, since China is already a large-scale producer and modest exporter of textiles and basic low technology machinery, the Bank thinks that China should probably strive to expand exports of these goods in which China is relatively competitive, especially by improving their quality.<sup>82</sup> On the other hand, in electronics products, China's cost of production is typically from five to ten times world prices, and their quality is poor. Thus, the Bank suggests that China would do better to import most of these rather than try to create, or recreate them, domestically at high

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<sup>81</sup> Ibid., p. 103.

<sup>82</sup> Ibid., pp. 104-5, 112-14.



cost.<sup>83</sup> This would usually lead to faster technology assimilation, since China's present strategy of self-development via re-creation means that many domestic products, such as computers, are out of date by the time they are finally produced. Moreover, obliging Chinese industry to use domestically manufactured electronics sacrifices future potential cost reductions and quality improvements.<sup>84</sup> Or, to take another case, it might also be argued that since China is a comparatively inefficient manufacturer of steel and alloys, it doesn't make sense from a strictly "economic" point of view for China to strive to be self-sufficient in steel, since the most efficient steel producers are right next door, in South Korea and Japan.

But in the foregoing examples, as elsewhere, the World Bank's perspective, which is typical of most Western

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<sup>83</sup> Moreover, the the Bank points out that "even when it is technically possible to copy foreign machinery, it may be uneconomic to do so. For example, the Shanghai Boiler Factory and Shanghai Number 3 Machine Tool Plant jointly designed a special deep-bore drill. The drill matches the technical quality of an imported product and may even have cost somewhat less, but it took several years to produce and will not be produced again. This illustrates the tendency [of China's planners] to concentrate only on the technical rather than the economic aspects of innovations." Ibid., p. 117.

<sup>84</sup> Ibid., pp. 115-17.

analysts, is distorted by its tendency to assess reform as if the goal of reform was to maximize the growth and profits -- the "performance" of individual firms. This approach would, again, be entirely sensible and rational if these enterprises were indeed discrete "firms" owned by discrete capitalists. But they are not, because in reality they are all branches of one gigantic state-firm. And from the standpoint of the collective owners of this giant state-firm, the bureaucracy, specialization by comparative advantage is not necessarily the most rational strategy to pursue.

For example: From the standpoint of individual capitalists in the United States, it is immaterial whether the United States possesses self-sufficiency in steel or electronics -- or for that matter, whether the U.S. economy produces steel or electronics at all. This is, obviously, because American capitalists are not interested in steel or electronics as such. They're interested in profits, and they're free to invest not only in the national but also the world economy, so they can and do shift production (or capital) out of inefficient industries, and into more competitive industries in the U.S. or offshore, when such a move is necessary to improve their corporations' profit picture. This is an important reason why, for example, USX Corporation (formerly US Steel Corp.) has diversified out of steel, and why there are virtually no more domestic

manufacturers of consumer electronics in the United States. It is true that the U.S. government is concerned about the loss of U.S. supremacy in steel and electronics -- partly because it is under pressure from domestic unions and local politicians to preserve jobs, but also for strategic reasons: because it wishes to maintain leadership and productive capacity in these (and certain other) fields to insure military surpemacy, which is, after all, ultimately essential to maintain the hegemony of U.S. capitalism. But since the U.S. government does not own the U.S. economy, it can only try to counter such trends indirectly, mainly by funding domestic military-related research and production, and by offering tax breaks to industires it wishes to promote.

#### **Basic Self-Sufficiency + Exports**

In China however, the bureaucratic owners of the economy do very much care about whether China possesses substantial capacity, if not self-sufficiency in steel and electronics, and for that matter, in grain. Their concern is rooted in their fear that to the extent they specialize in a world division of labor, to that extent they lose control over their economy and thus put themselves at the mercy of the world market and the multinational capitalists.

To really specialize, the bureaucracy would have to massively restructure investment, most likely closing down

"sunset" industries to shift resources into "sunrise" industries. At the same time, it would have to open up the Chinese economy to massive penetration of foreign capital, in order to supply those goods that China has given up producing. All this is fraught with huge risks for the bureaucracy. Huge investments could be sunk into export-oriented sectors, only to see them wasted should the world market turn against Chinese producers. At the same time, foreign capitalists could come to dominate much of the domestic economy, as in Taiwan, reducing the bureaucracy's economic base and ultimately, perhaps even posing a political threat to Communist rule. So, as we have seen, China's reformers have chosen not to reorganize their economy in ways which would maximize its comparative advantage in the world market. Instead, they have pursued a twofold strategy. They have sought to boost exports where possible to earn foreign exchange, but at the same time, have tried to maintain basic national self-sufficiency in most areas, and especially to develop their "own" new, high-technology industries, even when these can only be reproduced in China at substantially greater cost than simply buying the products of such industries on the world market.

Bureaucratic property relations also stand in the way of the reformers efforts to promote greater specialization and division of labor within the domestic economy itself.

Thus, in calling attention to the "urgent need for measures to reduce the present conflict between what is rational for a particular locality and what is rational for China's whole economy" the World Bank recommends that "the central government might consider legal measures to back up its existing general prohibition of barriers to interlocality trade, including possibly the establishment of a special regulatory institution, with the power to levy large fines."<sup>85</sup> But here again, were the government to do so, would face essentially the same problem it faces in attempting to fine state enterprises for other reasons (discussed above) -- namely, who is ultimately going to pay these fines? Particularly if the fines are "large," it is difficult to see how the central government could avoid simply fining itself, since to pay such sums, the localities would undoubtedly have to reduce profit and tax remittances to the state.

### **3. Intrabureaucratic Competition and its Implications for Economic Development**

Finally, let's turn to consider the ways in which bureaucratic property relations hamper the reformers

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<sup>85</sup> China: Long-Term Economic Development Issues and Options, p. 6.

efforts to force industrial directors to adopt more rational approaches to production, investment and reward. Under capitalism, industrial managers are generally led to adopt the most economically rational approaches to production, etc. not only because they are usually financially rewarded for improving firm profitability, but also because, as a rule, they face severe penalties up to and including dismissal, for failure to adopt the required efficiencies. Such penalties can be enforced, because, as Max Weber (after Marx) long ago pointed out, in contrast to the patrimonial and prebendal offices of ancient and feudal societies where officials held effective "possession" of income through assigned rents, benefices, fiefs, tax farms and the like, under capitalist property relations, industrial managers and government administrators (Weber identified the two for the purposes of this analysis) possess no ownership or property in their offices. Their positions do not depend upon personal relationships to superiors, but upon purely economic, viz. contractual relations of employment:<sup>86</sup>

In the rational type it is a matter of principle that the members of the administrative staff should be completely separated from ownership of the means of production or administration. Officials, employees, and workers . . . not themselves own the non-human means of production and administration. These are

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<sup>86</sup> Economy and Society, vol 1, pp. 218-19.

rather provided for their use in kind or in money, and the official is obligated to render an accounting of their use. There exists, furthermore, in principle complete separation of the organization's property (respectively capital), and the personal property (household) of the official."

Cut off from direct access to income through rents, etc. the capitalist manager who wishes to survive has no choice but to comply with the wishes of his superiors, to strive to make profits, therefore to rationalize production, to discipline himself and his subordinates to this end -- on pain of dismissal by the capitalist owners of the firm.<sup>87</sup>

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<sup>87</sup> Weber even went so far as to insist that this "purely economic" relationship rendered capitalist bureaucrats (including industrial managers) more "strictly subordinate" and subject to discipline than officials of ancient Egypt and Rome, who were in many instances factually and even legally slaves of their masters, and hence subject to direct and arbitrary coercion. His reasoning seems to be that coerced obedience, while perhaps effective in the short run, tended to alienate the subordinated official, thereby undermining his long-term reliability. In Weber's view, it was far more reliable to have a purely economic relationship that linked effective performance to self-interest. Thus experience shows, he remarked, that "the relative optimum for the success and maintenance of a strict mechanization of the bureaucratic apparatus is offered by a secured money salary connected with the opportunity of a career that is not dependent upon mere accident and arbitrariness." From Max Weber: Essays in Sociology, p. 208. Weber's analysis of bureaucratic rationality was closely bound up with his argument about the rationality of capitalism as a social organization of production as compared with pre-capitalist systems. On this see his The Protestant Ethic and the Spirit of Capitalism (New York: Scribner's, 1958), pp. 58-68ff. See also Weber's discussion of the implications of free vs. unfree labor with respect to economic development in eastern and western Germany in the late nineteenth century, summarized by Reinhard Bendix in Max Weber: An Intellectual Portrait (New York: Doubleday, 1960), pp. 14-41.

Of course to be sure, one can find many instances where in real life Weber's "ideal type" economic rationality is violated. Managers sometimes fail to make the most rational choices, subordinates conspire against superiors, officials are corrupted, and so on. Nevertheless, as a general rule, so long as capitalist property relations predominate, industrial managers must tend to respond to market signals according to the requirements of capitalist rationality.

#### **Bureaucratic Property and Bureaucratic Rationality**

But this is precisely why, in my view, such a capital logic has not worked and cannot be made to work in the industrial (or even fully in the agricultural) economy of China -- so long as the bureaucratic property relations prevail. Capitalist economic rationality presupposes capitalist property relations. But as with the patrimonial and prebendal officials of ancient and feudal society, in the bureaucratic system of China, industrial managers do in a very real sense "own" the means of production. That is, the industrial managers who run the economy do so as a byproduct of their positions in the bureaucracy, not by virtue of their expertise or performance. And it is their position in the bureaucracy which is in the first instance



the key to their power and income. Unlike capitalist managers, China's bureaucratic managers do not have to go through the market to survive, because they directly share in the collective social surplus which their state appropriates and redistributes to them according to their rank. By the same token, since they did not gain their managerial positions on the basis of their ability, neither can they, as a rule, lose their jobs for inadequate performance. Normally, China's industrial managers receive their allotted incomes regardless of their performance. This is the problem. This is not to say that incompetent managers are never fired in China. My argument is rather that as a rule industrial managers cannot be fired for inadequate performance or even gross incompetency as under capitalism, because there are no independent boards of directors, no outside "owners" with the power to do so; China's industrial managers are part of the same bureaucracy which owns the state, and therefore the means of discipline as well as the means of production. As the reformers regularly complain, those managers who enjoy the patronage of superiors usually keep their jobs, regardless of performance. By the same token even highly effective, efficient and enterprising managers cannot be assured of career success in the system unless they too have solid attachments to superiors. In other words, in China, success and failure in the bureaucratic system depend on

politics and not economics. Therefore, the prudent industrial manager has little choice but to pursue strategies which accord with the imperatives of what we might call bureaucratic rationality.

### **Conflicting Imperatives of Bureaucratic Surplus Extraction**

In China, managerial strategies are shaped by the overall logic and rationality of the bureaucratic system of surplus extraction. In China, unlike capitalism, members of the ruling class enjoy no economically determined security, no private property in the means of production or the social surplus. They hold their property, the state, in common. Their access to the social surplus depends upon their position in the hierarchy, and this is politically determined by appointment from above, through the nomenklatura system.<sup>88</sup> This means that the individual bureaucrat's access to income, potential for career advancement, and much else is entirely dependent upon highly personalized and politicized relationships with supe-

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<sup>88</sup> China's nomenklatura system is relatively unstudied, but see Melanie Manion's important article, "The cadre management system, post-Mao: the appointment, promotion, transfer and removal of party and state leaders," The China Quarterly, no. 102 (June 1985), pp. 203-33.

riors.<sup>89</sup> This property, or surplus extraction relationship -- centralized surplus extraction combined with collective bureaucratic property in the surplus and political redistribution of the surplus -- places contradictory imperatives upon the entire hierarchy of the bureaucracy, down to and including enterprise managers. The nature of this surplus extraction relationship is such that it compels individual members of the ruling class (and their followers in the descending ranks of the bureaucracy) to pursue political-economic strategies to secure their own positions and maximize their share of the social surplus, strategies which are indispensable for their own personal survival, but which are, all the same, highly dissonant with the aims of the class as a whole, to rationalize the economy, especially to conserve resources, cut costs and raise productivity.

On the one hand, because the bureaucracy's existence depends upon the strength of the state, and therefore the strength of the national economy, collectively, as a

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<sup>89</sup> It is interesting to note in this connection, that contrary to Max Weber's expectations with regard to "socialist society" here in the case of China, we have, if not a socialist society, at any rate a quintessentially bureaucratic society, and yet, relationships are not more objective, meritocratic, rational -- but instead are ironically, more personal, particularistic, unprofessional, etc. than in capitalist society. Cf. Economy and Society, vol. 1, pp. 223-5.

class, the bureaucracy must act to maximize accumulation, to accelerate economic development by cutting costs, boosting output and raising efficiency. This the bureaucracy must do, if it is ultimately to survive against internal and external threats. And in fact, despite all its problems, as we noted, China's ruling class has been able to carry out an impressive program of economic development. By virtue of its ability to suppress consumption and centralize a high proportion of the social surplus, to concentrate this surplus and channel resources and labor into planned industrialization, the bureaucracy has been able to sustain a rate of industrial growth of over 10% per year for three decades, a feat that has been equalled only by Japan. Furthermore, in the space of less than forty years it has also been able to fundamentally transform China from an impoverished, underdeveloped, mostly agrarian economy into significant industrial power. That the bureaucracy has been able to do this despite its astonishing waste of resources only indicates the real potential of the Chinese economy.

#### **The Political Economy of Guanxi**

On the other hand, because access to the social surplus is politically determined, and because in such a system the only guarantee of security is attachment to superior political patrons, individual bureaucrats must act to maximize their political influence, so must adopt

strategies designed to secure this political influence -- and these get in the way of (their collective goal of) rationalizing the economy. Thus, to survive and get ahead in the bureaucratic system, they must strive to construct and reinforce networks of instrumental-personal relationships, what the Chinese call guanxi (personal relations, or "connections"), based on existing family and work-based relationships, by welding together chains of patronage extending from the leaders in Beijing down through the provinces, counties to basic-level units, ties based on factional as well as institutional (i.e. ministerial, bureau, enterprise) alliances.<sup>90</sup> In such a highly politicized and personalized atmosphere, where political

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<sup>90</sup> It is in this general context that we must understand Professor Michael Oksenberg's perspicacious observation that in China "all attuned bureaucrats were intense 'Pekingologists,' closely charting how their man was doing in the Party pecking order." See his "Economic policymaking in China: summer 1981," The China Quarterly, no. 90 (June 1982), p. 184. Professor Andrew Walder has written a systematic and nuanced sociology of the economics of guanxi in his Communist Neo-Traditionalism chapter 5. Walder's focus is the network of formal/informal and "instrumental-personal" ties between workers and bosses at the factory level, but his elucidation of these quasi patron-client relationships is, I believe in many respects, equally applicable to relationships within the bureaucratic hierarchy of the party-state as a whole. The corrupting implications of guanxi has also been a favorite literary theme of China's new wave of short story writers. See especially Jiang Zilong's "Manager Qiao assumes office," "Pages from a factory secretary's diary" and Liu Binyan's "People or monsters?" (See bibliography).

instability and the arbitrary power of the leadership are the rule, everyone in the bureaucracy is driven to maximize political influence by the only means available -- by building networks of guanxi on the basis of mutual support and loyalty, and exchange of favors, regardless of economic rationality, objective merit, professional qualification, or the competence or performance of the individuals concerned. Furthermore, since in this system, individual bureaucratic property, or access to the social surplus is highly insecure, and in any case politically rather than economically determined, individual cadres, including managers, have little choice but to strive to hold onto or maximize their share of the surplus by pursuing particularistic strategies with respect to the economy -- by striving to appropriate centrally allocated resources by diverting investment funds to one's own ministry, bureau, enterprise, region, or municipality -- regardless of actual needs, and regardless of the balance of the economy as a whole -- through the pursuit of guanxi, paixing (factionalism), and the like.

#### **Rational Particularism: The Logic of Bureaucratic Competition**

Given the predominance of bureaucratic property relations, the pursuit of traditional strategies of bureaucratic competition (with all their concomitant economic irrationalities) becomes not only rational but

essential -- indeed, a law of survival and hence a law of motion of the bureaucratic system. At the top, this intra-bureaucratic competition takes the form of more or less incessant struggle to displace rival bureaucratic groups from control of the center. At the level of the firm, enterprise managers must strive to press their own firm's interests against all competing claimants on centrally distributed resources -- or risk seeing their share go to some other firm or bureau. This means that in general, firm managers must pursue strategies designed to maximize the income of the firm, instead of maximizing profitability. This, in turn, means that they cannot pursue capitalist type policies of trying to cut costs such as wages, or machinery and raw materials inputs, but instead, must strive to get more of all these inputs, strive to "overinvest." Thus in the World Bank study of Chongqing Clock and Watch Company, economists Byrd and Tidrick observed that:

Profit maximization, the conventional motivational assumption in models of capitalist enterprise behavior, appears at first glance to provide a better explanation of CCWC's behavior. Reforms have given CCWC control over a large amount of discretionary funds, and the company has made strong efforts to increase retained profits through output expansion, new product development, and manipulation of its administrative and incentive environment. However, under existing Chinese labor market conditions a profit-maximizing firm would probably try to restrict increases in wages, bonuses, and worker amenities. CCWC by contrast has often tried to increase worker benefits. Much of the company's

effort to manipulate the rules on calculation and use of retained income has been devoted to trying to increase workers' bonus or collective welfare payments.

Byrd and Tidrick concluded that instead of profit maximization, reformed enterprises appeared to follow a maximand equivalent to maximizing the sum of retained profits and wages.<sup>91</sup> Firms must strive for unlimited "blind" expansion of all inputs, because only by always demanding more than they need can they hope to get what they actually require. This of course has long been the pattern in the bureaucratic economies of Eastern Europe. As the Janos Kornai observed:

In a socialist economy there is no firm or nonprofit institution which does not want to invest. There is no saturation. Investment hunger is permanent. If an investment project just finished has appeased hunger momentarily, it will shortly reappear, and more intensively than ever.

Investment hunger, Kornai says, is the result of a tendency toward expansion which has become virtually a "natural instinct" of firm directors: "One must grow. Expansion drive joins quantity and hoarding tendency in creating a state of suction and the almost-insatiable

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<sup>91</sup> Byrd, et. al., Recent Chinese Economic Reforms, pp. 30-1.



demand in the production sphere."<sup>92</sup> Because the firms do not operate in a market economy, but in an economy which, even after the reforms, most resources are still distributed "politically" above the level of the firm, industrial managers have little choice but to strive to hoard raw materials, machinery and labor, and also to understate capacity and conceal potential, so as to meet unforeseen eventualities such as breakdowns or changes in demand. It also "makes sense" to start up new investments, even if the investment is unnecessary, or there is little or no prospect of finishing the project, because this is only another means of obtaining resources for the firm to carry on reproduction.<sup>93</sup>

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<sup>92</sup> The Economics of Shortage, 2 vols., (Amsterdam: North-Holland, 1980), volume A, pp. 191 & 193 (emphasis in original). See also his further comments along this line on pp. 194-95.

<sup>93</sup> Again, Professor Kornai: "From the claimant's point of view investment is a long campaign with many battles. But the whole campaign has only one life-and-death battle and that is at the beginning, since approval must be obtained for starting the investment. Once started, it will end in some way and at some time. That is exactly why it is possible to underestimate, without much hesitation, expected costs, and to forget about complementary investments. If costs are higher, or if investments above plan are necessary, money will surely be raised in one way or another. Perhaps the claimant will be blamed for erroneous calculations, perhaps work will slow down for a while to wait for financial cover, but an investment project that has been started will not be stopped for good." Ibid. p. 197 (emphasis in the original).

Similarly, to get access to the necessary material and human resources in the context of politically determined distribution, managers must devote considerable effort to cultivating guanxi, must "go through the back door" and use political/patronage/covert means, again, because they cannot simply go out on the market and buy these things, because there is no real or sufficient market. It has been observed that some industrial managers spend practically all their time in such maneuvering, and with good reason. In his study of industrial executives, Walder reported that "plant directors . . . spend so much of their time at the leading organs, and with potential suppliers, that the subordinates sometimes referred to them as 'ministers of foreign affairs.' "94 Likewise, it also makes sense for local managers and officials to pursue strategies of self-sufficiency, to invest in duplicate or redundant production capacity. This becomes logical and rational because since there is no free market in means of production, producers cannot depend on outside suppliers, and so firms and localities must strive to possess all they require, because they cannot be regularly assured of

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94 "The informal dimension," p. 642. See also his "Industrial reform in China: the human dimension," in The Limits of Reform edited by Ronald A. Morse (Boulder Colo.: Westview Press, 1983), p. 54.

getting needed inputs through normal bureaucratic channels.<sup>95</sup>

A decade ago, when the brave new world of market socialism was still on the horizon, the reformers entertained the hope that the development of the free market would overwhelm this essentially corrupt and wasteful subterranean economy, rendering all exchange free and overt. Instead, as we have seen, the reformers retreated on the free market, and the net result has been the vast growth of corruption. Far from undermining bureaucratic modes of behavior, the reforms themselves have been undermined by the requirements of reproduction in the bureaucratic system.

#### **The Logic of Recentralization**

Now it goes without saying that China's reform leadership and their Western advisors, view the pursuit of such particularistic, covert, and "irrational" strategies with horror. But, as I have tried to show, the pursuit of such strategies is not entirely irrational, at least not within the context of a bureaucratic class structure. Nor, in my view, can such "uneconomic" behavior be explained as simply a hangover from China's feudal past, as the Chinese and some Western scholars maintain -- since, evidently,

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<sup>95</sup> Walder, "The informal dimension," p. 636 note 13.

such cultural baggage is no great restraint on the development of free market behavior in Hong Kong or elsewhere. Rather, it is the requirements of bureaucratic reproduction that leave individual members of the bureaucratic ruling class (and their subordinates) little choice but to pursue policies with respect to the economy that systematically subvert reform and undermine their own collective goal of maximizing economic efficiency, but which are all the same, indispensable for their own individual survival in the bureaucratic system.

Given powerful tendencies at every level below the center to skew planning, resource allocation and income distribution in their own interests, and given the center's evident inability to overcome these tendencies and reassert its plan by means of "economic levers," it is hardly surprising that Deng and Zhao have become fearful of "letting go" of the industrial economy. Indeed, although he has strongly argued the case for market decentralization for years, the reformer-economist Xue Muqiao has noted the considerable force of arguments in favor of recentralization:<sup>96</sup>

Some people say there is too much centralized control over materials, and control is excessive. But the ministries in charge of these materials maintain that

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<sup>96</sup> "An inquiry problems concerning reform" (1980) op. cit. p. 8.

in reality they have control over only some ten to twenty percent of the materials; the greater part of these materials are individually stored in warehouses of the various ministries, bureaus, and industries; if you want prompt and flexible distribution of the materials, you must allow the greater part of the materials to be centralized in the hands of the ministries in charge of the management of these materials just as it is with the ministry of commerce. Thus centralisation is necessary.

Evidently, given the disastrous results of decentralization in recent years, this is the conclusion Deng and Zhao have finally come to in announcing the massive recentralization of the fall of 1988. Of course, recentralization resolves nothing and has only revived all the original problems of the system.

In sum, the contradictory imperatives of bureaucratic surplus extraction compel China's ruling class to pursue such "economic" and "uneconomic" strategies simultaneously, and it is in this simultaneous pursuit of both efficient and inefficient policies, that is to be found an important source of the contradictory pattern of China's economic growth. The importance and power of these contradictory impulses is, to my mind, indispensable for understanding the motivations and actions of China's industrial managers and also of the reformers at the top, and why reforms continue to be overridden by the reformers.

#### **A Way out of the Impasse?**

Is there a way out of this seemingly endless cycle of

reform and recentralization? The consensus of the leading experts in the field is that if China's reforms, especially the industrial reforms, are ever to succeed, the government is going to have to, finally, abandon its direct management of the economy. In the words of industrial sociologist Andrew Walder: "the reforms will stagnate if they fail to create efficient industrial administrations -- and a prerequisite to such efficiency is the disentangling of decision-making from the noneconomic considerations with which it has become so enmeshed in decades past."<sup>97</sup> In his view:<sup>98</sup>

The financial constraints on enterprises must be significantly "hardened," and this cannot be accomplished simply by devising new schemes for dividing revenues and offering incentives to factory managers. The first step, as many Chinese and western writers have already pointed out, is an overhaul of China's price system. But beyond that is an equally intractable problem: to carry through a re-design of relationships at the lowest levels of the economic bureaucracy.

Such a transformation, Walder suggests, will only come about through gradual incremental change: "The problems we have outlined will respond slowly to a sustained and con-

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<sup>97</sup> "Industrial reform in China," op. cit., p. 41.

<sup>98</sup> "The informal dimension of enterprise financial reforms," op. cit., p. 644. Also see Janos Kornai's comments on the Chinese reforms in his article, "The soft budget constraint." Kyklos, vol. 39 (1986), pp. 3-30

sistent economic and political policy, applied over several decades time."<sup>99</sup>

Yet the question may be asked, how can the leadership "redesign" these bureaucratic relationships (fundamentally, relations of intra-bureaucratic solidarity and mutual support), which are, as I've tried to demonstrate, key to the existence, domination, and reproduction of the bureaucracy as a ruling class? Redesign them how? Impose "hard budget constraints?" Impose bankruptcy and let the state's inefficient firms be driven out of business? Break the iron rice bowl and create a class of idle unemployed? Let the market override (i.e. defeat) the plan? These are the sorts of measures that would really be required to get the kind of market rationality the reformers want. But, precisely because all such moves could only undermine the bureaucracy's Plan, and thereby threaten their position and dominance, the reformers, acting out of their instinct of self-preservation, have invariably stepped in to block the development of real markets.

Similarly, how can the economic be "disentangled" from the political when, in the bureaucratic system, property and surplus extraction are collectivized through the state, instead of privatized as under capitalism. To sepa-

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<sup>99</sup> "Industrial reform in China," op cit. p. 59.

rate the state from civil society would require revolutionary transformation: the abolition of bureaucratic property and surplus extraction relations, and the institution of capitalist property relations -- in short, not incremental change, but a bourgeois revolution.

#### **IV. CONCLUSION: CLASS STRUCTURE, ECONOMIC RATIONALITY, AND REVOLUTION**

Now some might take the foregoing analysis of the contradictions and limitations of China's market socialist reform project, as an argument for a wholesale resumption of capitalist property relations in China, as a way out of the present crisis. That is very far from my intention. An important point of this thesis has been to demonstrate that, pace the theorists of market socialism, "economic rationality" cannot be understood in the abstract, apart from specific, historically formed class structures, because different class or surplus extraction relations give rise to different economic rationalities. What is rational under capitalism is not rational in the bureaucratic mode of production and vice versa.

One of the ironies of market reform in China is that to the extent that it worked at all, it did so only where real capitalist relations of production developed, notably in agriculture. This did indeed lead to the adoption of capitalist-type economic rationality -- specialization,



competition, rising productivity, and so forth. But, inevitably, like everywhere else in the developing capitalist world, such capitalist development also resulted in the expropriation of masses of peasants from the land, in mass unemployment, in the impoverishment of the many to enrich the few, in the growth of overproduction and waste, and so on.

Those on the left, like Professor Mark Selden and others who hope for a socialist outcome in China, have naturally been reluctant to accept the full implications of their market prescription. But the problem is that those who advocate market solutions and capitalist rationality, forget that the same market-driven competition that forces capitalists and workers to efficiencies within the firm, is also responsible for the general irrationality of the capitalist system as a whole -- that is, for unemployment, for the economic and cultural impoverishment of the great mass of the world's proletariat, for the wanton disregard by profit-minded self-interest-seeking owners of corporations for the health of their workers, the consumers, or the environment, for periodic crises (as we have recently been reminded), for periodic massive economic collapse (as we may soon see again) and ultimately, for wars. These are only two sides of the same capital logic, the same competitive "rationality." The fundamental naïveté of left

market socialists is their assumption that the Chinese reformers could get the best without the worst of the market system.

Now, to say this is not at all to imply that the bureaucratic economies do not produce many of these same irrationalities, and others. Indeed, in my view, they are driven by a quite different dynamic and logic, have a different internal rationality, and they produce many of the same but also some significantly different contradictions, specific to that mode of production (e.g. in the bureaucratic system, labor discipline must mainly be enforced via extra-economic coercion rather than the threat of unemployment, and this, as we saw, holds quite different implications with respect to the problem of developing productivity). The problem today, is that we live in a world that is dominated by two detestable social systems. The problems of both capitalist and bureaucratic systems result from the respective contradictions of these systems, which make different but equally inefficient, wasteful, and ultimately destructive policies "rational" in both these social systems. This does not mean that these are the only possible social systems, and that we have to choose between the market or the bureaucratic plan. Doubtless some, even perhaps most of China's ruling bureaucracy might wish to trade their system for the other. Their problem is how to effect a transition, how to

effect a buyout in such a way that they could still stay on top.

The task for socialists in China, however, is not to choose one or the other of these wretched systems, but to work to construct a third rationality -- a rationality that gears production to the needs of the many, instead of the few, that encourages the fullest development of every individual, and encourages the most socially rational utilization of the economy and the environment -- the rationality of democratically planned self-managed socialism. As the pro-democracy movement in China is finding out, such a truly socialist rationality cannot come from top-down bureaucratic reforms, but will require a social revolution, from the bottom up.

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