

## THE MAIN ASPECTS OF CHINA'S ECONOMIC REFORM

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### I THE URGENCY OF ECONOMIC REFORM

During the 35 years since the founding of the People's Republic of China in 1949, China's economic development has been carried out within a framework of central planning and the public ownership of means of production. The record shows that public ownership and central planning have made substantial and solidly-based economic progress possible. But highly centralized planning is not sufficiently flexible. During the period of the First Five Year Plan (1953—1957), with the completion of socialist transformation, the defects of excessive and rigid control gradually became manifest in several aspects: the power of management was overconcentrated at central level and enterprises lacked the power of decision; the forms of economy lacked diversity; the law of value and the principle of distribution according to work were neglected; administrative divisions became a barrier to production and circulation.

Prevailing practices have become a hindrance to the expansion and modernization of the economy. If we had not begun economic reform to establish new organizational structures and institutions to assist the pace of economic development, the aim of modernization would not be realized, nor the quadrupling of the gross annual value of industrial and agricultural production by the end of this century.

### II ECONOMIC REFORM AS THE BREAKTHROUGH IN CHINA'S TRADITIONALLY OSSIFIED ECONOMIC METHODS

The processes China has been passing through can be briefly outlined as follows:

#### (1) *Reform progressing from countryside to urban centres*

China's economic reform is divided into two phases. It began first in the countryside, following the decision of the Third Planning Session of the Party's Eleventh Central Committee held at the end

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of 1978, to shift the focus of work to economic contribution. Since then, in a very short time, tremendous changes have taken place in the countryside. The people's communes, the dominant form of rural grass-roots organization over the past 25 years, have been stripped of their government functions, leaving them as purely economic entities. By the end of 1984, more than 90,000 township governments had been set up to replace the government functions of the communes. They are responsible only for administrative affairs and planning the local economy, for taxes, markets, disaster relief, public security, welfare, health, culture and education. They will mainly be in charge of organizing production of local collectively-run enterprises. The commune members will be left free to determine their own production.

The other important economic reform was that the household contract responsibility system became the principal method of management. The contract is signed by the state, the collective and the peasant household. Usually, the state works out a plan, designating crop production for a particular area. According to this plan, the production team contracts out the land to the peasant households; they can use the land, but have no right to sell, lease or transfer it since it is owned collectively. Likewise, large farm machines are operated by the collective as well as water conservation, while medium and small-size farm tools are distributed by the production team to the peasant household. This operation, based on public ownership of the means of production, has thus become a new form of socialist co-operative economy.

During 1984 the government implemented further measures, including the lengthening of the period of contract, the easing of conditions for hiring rural labour and steps to promote the division of labour and specialization in agricultural-related services, trade and certain small industrial activities. The system of contractual responsibility is thus extended to the entire rural economy.

The contract eliminates the absolute egalitarianism of the previous system and links the peasants' remuneration with their labour and with output. Distribution under this system is as follows:

The state receives agricultural taxes and a set amount of products from the peasant household. The production team retains a share of earnings from product sales for developing production, improving public welfare and helping households in difficulties. The peasant household owns the remaining portion.

A number of specialized households have emerged since the household contract responsibility system began. Their members are comparatively skilled and experienced, are good at intensive farming, and can thus achieve greater labour productivity. The amount of commodities supplied by a single specialized household is often more than that produced by an entire production team in the past.

Some specialized households involved in such activities as poultry and pig-farming, transportation and trading and so on, are self-managing, with the means of production owned by themselves. They have economic ties with state-owned enterprises and collective economic organizations through production plans and production-supply-marketing contracts. This kind of specialized household has already

become a component of the socialist economy and is influenced by the state through policies, decrees and laws, used as economic levers for maintaining a socialist orientation.

This system is undeniably a big step forward from past days. It has clear division of labour, and gives more scope to the peasants' talents, enabling the specialized households to prosper first (according to a 1984 survey by the Hebei Provincial Statistical Bureau, 153 out of 1,018 families, 15% of the total, earned more than 10,000 yuans from specialized trades). Through their example the broad mass of peasants is encouraged to become better off through their labour and thus reach the goal of common prosperity.

As the division of labour becomes more specific, specialized production associations and technical service associations have been established. The development of multiple associations will further activate commodity production, shifting from selling only primary products to selling processed products, thus stimulating rural processing industries. More and more surplus rural workers have turned to nonagricultural production. At the end of 1984, a quarter of the rural labour force was working in industry, construction, transportation, commerce, catering and service trades. Some farmers have moved to the towns and cities to set up factories and shops.

As reform has achieved such a favourable outcome in the rural economy, the time is ripe to extend it to the urban economy.

## *(2) Invigorating enterprises and undertaking macroeconomic regulation*

»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 Communist Party of China at its Third Plenary Session on October 20th, 1984, is a historic document. It points out that as a new technological revolution emerges on a global scale, China's economic structure must become better able to utilize the latest scientific and technological achievements, promoting scientific and technological advancement and generating new forces of production. The cities are the economic, political, scientific, technological, cultural and educational centres where modern industry and members of the working class are concentrated, and they play the leading role in socialist modernization, enlivening the domestic economy as well as opening it up to the outside world. But there are many defects in the urban economic structure, the economic effectiveness of our urban enterprises is still very low, loss and waste in production, construction and circulation are serious, so invigorating the urban enterprises is the key to restructuring the national economy. The urban enterprise undertakes the chief and direct responsibility for industrial production and construction and commodity circulation. China now has over one million urban industrial, building, transportation, commercial and service enterprises, with a total work force of more than 80 million. The taxes and profits delivered by urban industrial enterprises alone account for over 80 per cent of the state's revenue. Therefore it is very important to

instil vitality into the enterprises, particularly the large and medium-sized enterprises owned by the people as a whole, for the purpose of improving the national economy and the state's financial and economic situation, and quadrupling China's annual industrial and agricultural output by the end of the century. The document provides two ways of achieving this goal: (a) extending the decision-making power of enterprises owned by the people by establishing a correct relationship between them and the state; (b) safeguarding the status of the workers and staff members as masters of the enterprises by establishing correct relationships between them and their enterprises.

(a) In the past, the state concentrated excessive power in its own hands because of the traditional concept that as the enterprises are owned by the whole people, they should be managed exclusively by the socialist state on behalf of the people. This reduced enterprises to mere appendages of state institutions.

According to Marxist theory and the practice of socialism, the ownership of an enterprise can properly be separated from its management powers. Since social demand is very complicated and is ever-changing, and conditions in enterprises differ in a thousand and one ways, no state institution can be aware of the whole situation and respond to all changes. If the state institutions were to directly administer and manage all kinds of enterprises owned by the whole people, subjectivism and bureaucratism which consequently suppress an enterprise's vitality could not be avoided.

Enterprises have been granted more decision-making power and assured of not being subjected to interference, a problem which has not been dealt with in the past. The reform now separates state economic guidance from the enterprises' power to manage their own affairs, in order to promote improvements in enterprises' efficiency, higher productivity and a more effective response to changing demands, involving changes in both organization and management. The great majority of state enterprises will be free to determine their own policies with respect to production, sales, prices, labour management and investment within overall guidelines laid down through fiscal and credit measures and control over certain basic resources.

Correct relations between the state and the enterprise calls for the reform of various aspects of the entire economic structure. This involves a whole range of reform including planning, pricing, economic management by state institutions and the labour and wage system. Economic departments at various levels, especially those in charge of comprehensive economic management must learn to use economic levers, paying close attention to macroeconomic regulation and economic trends so as to use pricing, taxation, credit and other economic levers better. This will help regulate such major proportional relations as those between aggregate social supply and aggregate social demand, between accumulation and consumption, regulate the direction of the flow of financial, material and human resources, regulate the industrial set-ups and the distribution of the forces of production, regulate market supply and demand, external economic exchange and so on. The state institution must manage, inspect, guide and regulate the activities of enterprises and concentrate in its treasury that part of enterprises' net income which should be used by

the state in a unified way; it must designate, appoint or remove the principal leading members of the enterprises or approve their employment and election and must decide on the establishment of enterprises, their removal to other places, their switching over to other lines of products, their merger with others, suspension of operations or closing down.

(b) The enterprises' decision-making powers and responsibilities have to be shared among the workers and staff members who, guaranteed by rules and regulations as masters of the enterprises, can work as such in their jobs, their wages and bonuses being differentiated according to level of skill, training, seniority and effort involved. It is the intention that wages should reflect the individual's contributions as well as the performance and profitability of the enterprises so as to promote higher productivity and give the workforce an interest in the efficiency of the enterprise and its success in meeting market demands. The right of workers and staff and their elected representatives to participate in the democratic management of the enterprise must be resolutely ensured.

Correct relations between the state and enterprise and between an enterprise and its workers and staff are the essence and basic requirement of the restructuring of the national economy as a whole with the focus on the cities. Under such relations, it is possible to abolish egalitarianism and implement the socialist principle of distribution according to work.

### (3) *The law of value as the theoretical basis of reform*

The Chinese planning system has long been established on the basis that since a socialist economy is a planned one, it ought to embrace every aspect of economic life, ignoring the actual conditions prevalent in the country — its vast territory, large population, poor transport conditions, inadequate information facilities, the obviously uneven economic and cultural development of its various regions and so on. Such plans could only be implemented by an excessive number of administrative orders and an over-concentrated power of management at the centre. For a long time, the enterprises have lacked power of decision, and mandatory plans have been predominant. There is an unavoidable discrepancy between the subjective guidelines for planning and objective conditions.

Not long after liberation, China fundamentally adopted Stalin's planning management system. This regarded the exchange between the state economy and collective economy as belonging to commodity exchange, while the exchange between state-owned enterprises did not belong to commodity exchange, because ownership did not transfer in essence, and thus did not need to follow the principle of equal price exchange.

An important part of the current economic restructuring is the relaxation of the overly rigid control of the state plan, the establishment of a planning system under which the law of value is consciously observed and the development of a socialist commodity economy. The October 1984 document mentioned above points out that our

practical experience has made us realize that, for a long time to come, our national economic plans can on the whole only be rough and elastic, exercising effective control over major issues while allowing flexibility on minor ones. Our planned economy does not necessarily mean the predominance of mandatory planning, so the scope of mandatory plans must necessarily be reduced and the scope of guidance planning extended. The latter is achieved mainly by the use of economic levers, while the former has to be implemented, even though the law of value must be observed. Since our socialist planned economy is also a kind of commodity economy, and since the full development of a commodity economy is an indispensable stage in the economic growth of society and a prerequisite for our economic modernization, we cannot rely only on administrative means and mandatory plans. The law of value and market mechanism will be widely used as an important basis for economic planning. For instance, commodity prices will be fixed and readjusted according to their real value; social labour will be more sensibly and proportionally distributed according to production quotas and the amount of labour and raw materials consumed.

The shift to a more flexible system of planning requires the development of alternative broader forms of control, especially general fiscal and monetary instruments that will allow greater scope for the play of market forces. In fact, certain important changes in this direction have already been introduced. The main objectives of monetary policy are: to control the expansion of currency issue and credit for anti-inflationary purposes; to provide necessary credits for industrial enterprises and agricultural households for carrying out structural adjustments and new investments; and to conduct an active interest rate policy designed to influence the rate of investment and savings.

Among fiscal measures, a reform which is extremely important in several connections is the substitution of tax calculated as a proportion of profits in place of the automatic transfer of profits to the government budget. This change has now been extended to all state-owned enterprises. The possibility of varying the tax rate gives the authorities scope to influence the operations of the enterprises. The authorities are hopeful that the change to a tax on profit will provide enterprises with an important incentive to improve efficiency and secure reductions in cost and also to measure their cost-effectiveness. Furthermore, the authorities have recently adopted many new taxes aiming at establishing a comprehensive system of taxes on all industrial and commercial enterprises.

(4) *Reform of the price system as the key to reform of the entire economic structure*

A systematic and comprehensive price reform is regarded by the government as an essential element of the general reform programme. The basic objective of the reform is that price relationships should reflect both relative costs and the supply and demand situation.

There is much confusion in our present system of pricing, because the law of value has long been neglected and because of various other historical reasons. The prices of many commodities reflect neither their value nor supply-demand relations. The present irrational price system finds expression mainly in the following:

(a) Irrational price ratios between different commodities

The prices of some material products and raw and semi-finished material are very low, but owing to the low levels of technology and management in our enterprises, the cost of the products made with these low-priced raw materials are very high, much higher even than those of the same kind of products in the world market. As a result, it is difficult to stimulate enterprises producing raw material and energy to raise the amount of production, and spur the processing enterprises to improve techniques and management, so as to encourage technological progress and raise economic efficiency;

(b) The retail price of major farm and sideline products is lower than their state purchasing price

During the thirty years between the founding of the People's Republic of China and the Third Plenary Session of the Party's Eleventh Central Committee, the development of agricultural production was very slow, and the living standard of farmers did not improve. One of the important reasons was that the state purchasing price of farm and sideline products was too low to stimulate the farmers' enthusiasm for developing agricultural production. After the Third Plenary Session, purchasing prices of a large range of sideline products were raised. But, as selling prices have remained unchanged, subsidies for the purchasing of agricultural products have increased year by year: the more agricultural production increases, the greater the amount of subsidies. Limitations on state financial capacity must finally effect the advanced development of agriculture. It is not only causes unfavourable conditions for increasing agricultural production to meet the needs of the processing industry, but also the circulation and adjustment of commodities between regions is very difficult.

(c) Inadequate price differentials for a given product with diverse quality

The price of a given product is not regulated according to its quality, with a higher price for the best and lower price for the worst. As a result, supply of the best products cannot meet demand whereas the worst products are unsaleable. What is more, production of the former does not increase and that of the latter does not reduce. Such a situation hampers the endeavours of an enterprise to raise the quality of products and develop new ones.

Under such circumstances, establishing a rational system of pricing and reforming the system of price control are the more urgent in our present economic reform. The principles guiding reform would be:

- (i) Readjusting irrational price ratios on the basis of the exchange of equal value and changes in the relation between supply and demand

In any historical period and in any country, the prices of every kind of commodity are continually changing. Generally speaking, some will rise and some will fall, but the general price level remains fundamentally unchanged, yet in China the concept of price stability has long been set against that of price adjustment. As a result, the prices of many commodities have not reflected the exchange of equal value and changes in the relation between supply and demand.

In recent years, as the production of agriculture and light industry has increased rapidly, and the market supply of consumer goods has become better and better, conditions for changing the irrational price ratio have existed, prices being lowered and raised as the case may be. Our price policy is not only to make price conform to value, but also in a timely fashion to adjust the price according to the changes of supply and demand, i. e. making full use of the law of value. While the production costs of millions of commodities constantly vary as science and technology progress day by day, it is impossible for the price department to regulate a price for each of these commodities. So except for a very few products whose demand exceeds supply and whose price has to be planned mandatorily, the majority of these commodities can be regulated by the market. Only in this case can the principle of giving a higher price to the best quality and lower price to the worst be fully embodied.

- (ii) Avoiding the rise in the market sales prices of manufactured consumer goods

Because we have neglected price-adjusting for a long time, the prices of some mineral products and raw and semi-finished materials are extremely low; to raise their price would increase the production costs of a processing enterprise, and thus affect its profit. The state must be very prudent, and attempt to raise prices step by step. In response to the raising of prices, an enterprise will be forced to cut down input, concern itself with conservation of energy and raw materials, and increase economic efficiency. Of course, the establishment of energy conservation needs some investment, the recoupment of which will take two or three years. Enterprises must therefore expect some difficulties in this aspect. The state will give subsidies to a few high energy-consuming products through tax reductions and exemptions, so the cost increase resulting from the higher price of such materials can be basically offset within the enterprise and the market sales prices of the manufactured consumer goods will not be raised.

- (iii) Ensuring that the real income of urban and rural inhabitants does not fall as a result of price readjustment

The state purchases farm and sideline products at prices higher than their selling price. Owing to this difference, the sum of subsidies



has increased as agricultural production has developed and has become one of the important reasons for financial deficit in recent years. The state's efforts to resolve the problem of »everyone eating from the same big pot« were started in rural areas and then extended to the cities. It seems that rural areas will again take the lead in price reform. It will be the second major step in the reform of the rural economic structure, since the introduction of the contracted responsibility system with remuneration linked to output. The countryside now has all the necessary conditions for abolishing the exclusive rights of the state in purchasing and selling agricultural products. More flexible policies whereby market regulation will be applied to agricultural and sideline products will be adopted step by step. State companies, farms and other enterprises will actively take part in market regulation.

Necessary price readjustment and reform will be carried out with regard to a small number of industrial products. The aim is to give an impetus to the rationalization of the industrial structure without affecting the overall balance. All enterprises should achieve better economic results through efforts to improve management and operations. The method of directly linking pay increases for the workers to the enterprises' economic performance will be widely adopted, so that price increases will be compensated for by wage increases made possible by improvements in productivity. The state will increase pay for middle and primary school teachers starting from this year and will carry out reforms of the pay system in state institutions including those in the fields of science, technology, culture and education.

It should be pointed out that need for major changes in the price system poses perhaps the most difficult problem facing the government. Certain price reform measures have already been implemented over the past few years. Preparations are now underway for a pragmatic and feasible programme of price reform. It will take into account the rate of growth of production, the impact of price changes on the state budget and the need to gradually increase the real income of the population.

For many years, we have adopted a rigid price control system, and the market mechanism is not very flexible. In order not to bring about a general and spiralling rise in prices, the range of rises will not for the time being be as large as the range of price reductions.

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