

# Introduction: The Difficulties of Transition from a Planned to a Market Economy

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## *Commonalities with the Former Soviet Union and Other Eastern European Socialist Countries*

The socialist regimes based on one-party dictatorship in the Soviet Union and other Eastern European countries collapsed in rapid succession during a very brief period of time. The democratization and consequent overthrow of the traditional socialist regimes now seems to be a powerful tide that no one can stop. Certainly China cannot remain insulated from this historic tide. China's system of one-party dictatorship and central control of the economy suffers from the same difficulties as were faced earlier by the former Soviet Union and Eastern European countries. The common difficulties faced by all of these countries can be set down in the following five points.

First, privilege and corruption, characteristic of one-party dictatorship, have become widespread among party cadres and bureaucrats. The situation has remained unchanged through both the pre-reform and reform periods. In China the market prices introduced by price reform are twice or even three times higher, depending on the items, than the official prices. Exploiting these differentials, paper companies set up by government officials have been earning extortionate profits.

Second, as has been pointed out over the years, the centrally controlled economy is plagued by chronic defects, and the economic weight of central control has been systematically declining. As production increases with the development of the economy, the central government's information-processing capacity has lagged behind the requirements of expanding economic output.

Under the priority production system with its emphasis on the preferential

development of heavy industries, the classic central economic control based on directives issued by the central government used to function more or less positively. But as the world entered into a period of high-tech development in the second half of the 1970s, Chinese products failed to keep technologically abreast with Western products due to the lack of competition which characterizes this type of socialist system. Television sets, cameras, and other consumer durables made in the West are all more compact, higher in quality, and more durable than their counterparts produced in socialist countries, which are all large, heavy, and clumsy.

Third, China has experienced the same contradictions as the Soviet Union and the Eastern European socialist countries experienced in their transition from a planned economy to a market economy. The Soviet Union and Eastern Europe started reforms in the 1960s, and China turned to an economic reform policy between the end of the 1970s. Accelerated inflation and income gaps among the rich and the poor are some of the contradictions which have generated discontent among the masses. In the Soviet coal mines, strikes broke out frequently demanding a sufficient supply of soap, towels, and other daily necessities. To placate the disgruntled masses, the government had to accept wage increases and pay price subsidies. This in turn increased fiscal deficits which accelerated further inflation. A vicious circle thus set in.

Progressive inflation and general decline in national economic power weakened the country's currency. The official exchange rate became only nominal as the black-market rate became prevalent and effective. A people having no confidence in their country's currency can hardly have respect for the regime.

Fourth, due to the development of the communications industry, it is no longer possible for socialist countries to remain closed to information from the West. In the former Czechoslovakia people were watching TV programs broadcast from West Germany. The Chinese can obtain Western information through the radio. As the open-economy program has progressed, visiting overseas Chinese, students who had studied abroad, and visiting tourists have brought information about the West to the people of Mainland China.

Today a Chinese who has worked in Japan as a migrant worker for a few years can bring home two million yen or so with which he can even build a large residence in his native town or village. Knowing this, more and more Chinese are frustrated by the present regime which restricts freedom of travel abroad. Many are attracted to Western standards of living. The spectacular development of the Asian NIEs also causes particular feelings of envy among the Chinese as China and these countries started from about the same standards of living at the end of World War II.

Fifth, the socialist regime lacks the shock absorbers which exist in the West that serve to mitigate conflicts between the people and the powers that be. Western countries not only have democratic institutions such as free elections, but they also have other facilities which absorb or dissipate public discontent.

Even in Western countries, not all are satisfied with their current life. Rather, many suffer terribly from stress and tensions arising from the serious competition of capitalism. In Japan working people have to do long overtime and then go home in extremely crowded commuter trains. Their life is very exhausting. But they can have a drink at a cheap tavern and sing at a *karaoke* bar on their way home, or relax a little bit watching a baseball game or a TV show after going home. Or they can play golf or tennis on Sundays. Thus, their discontent with the regime is effectively vented. If they go in for gambling, such as mah-jongg, pinball games, bicycle races, or horse races, nothing is more important than winning or losing, and they have no energy left for political activities.

### *Specific Characteristics of Chinese Socialism*

As well as having traits that are common with the former Soviet and Eastern European socialism, Chinese socialism also has its own characteristics which are important to note, and we should not discuss the future of the Chinese political and economic systems without reference to these specific characteristics. These can be set forth in the following six points.

First, the Chinese level of economic development is still lower than that of the former Soviet Union and Eastern European countries. The rural population accounts for 80 per cent of the total population and is still based substantially on a non-commodity economy.

Second, Eastern European socialism was a system imposed by the Soviet Union. The Hungarian uprising in 1956, the Prague Spring of 1968, and the other movements for democracy were all crushed by Soviet tanks. In contrast, the socialist regime in China was established through the Chinese people's own resistance against invasion by the Japanese army and through the civil war between the Nationalists (Kuomintang) and the Communist Party of China. China thus adhered to its own socialist model even during the Sino-Soviet conflict of the 1960s. This being the case, there is no logical reason why China should abandon its socialist regime just because the Soviet Union has done so.

Third, the distribution of Western information in China is not as rapid or as widespread as it was in Eastern Europe. Czechoslovakia and East Germany bordered on West Germany. The citizens of these countries thus were able to watch West German TV news and commercials especially after government control was loosened. The Eastern Europeans as Europeans had similar values and shared the same information as their Western counterparts, and the increase in the number of households owning TV sets undermined government information control.

In contrast, less than 40 per cent of Chinese households have TV sets, and of those most can only receive provincial TV stations. China Central Television programming reaches only a few regions. Western information broadcasts from abroad never reach the vast rural areas of China. Only in Guangdong Province are TV antennas of most households directed toward neighboring Hong

Kong. In some big cities such as Beijing satellite broadcasts of overseas television programs are available since around 1991, but only foreigners and a limited number of people can enjoy them.

Fourth, the Chinese social and cultural conditions are greatly different from those of the former Soviet Union and Eastern European societies. For instance, China still has a social climate where popular discontent easily explodes into violence. In 1987 when an additional personal income tax was introduced, tax officers were attacked by the masses in many places, leaving seven dead, six maimed, and 263 seriously wounded. Violence against primary and junior high school teachers carried out by the families of students is frequent. In 1987 three teachers were killed, 26 disabled, and 13 seriously injured in Henan Province alone.

School education has spread rather widely, but the illiteracy rate is still high. Even now, more than 30 per cent of the population is either totally or partially illiterate.

Fifth, China has a vast territory and a huge population. It is twice the size of Europe excluding the former Soviet Union. During the past ten odd years of reform, 19 million small and medium-sized enterprises have developed in the countryside employing a total of 100 million people. Unlike the state-owned enterprises, these small firms do not necessarily follow the state's food-safety standards, and many of the small and medium-sized enterprises are the ones that are polluting the rural areas with their waste. As a relatively flat continental country, China's geography is not suitable for the easy disposal of pollution. Furthermore, during the 1960s the Chinese government adopted a policy of promoting the construction of industrial factories in inland areas. All this indicates that unless the central government uses its strong power to control pollution and food safety, a very dangerous situation could easily arise.

Some Eastern European countries and the former Soviet Union suffered from labor shortages and used migrant workers. Former East Germany and Hungary experienced a decrease in their population. However, China's population, now standing at 1.2 billion, is 400 million more than the total population of Europe and the former Soviet Union combined. Despite its strict "single-child policy," the population is increasing by 15 million every year. It is also said that by 2000 roughly 20 million people in urban areas and 180 million people in the countryside, a total of 200 million people, will be latently unemployed. The number is equal in size to the total population of Japan, South and North Korea, Hong Kong, and Taiwan put together. During spring and summer every year, one to two million people flow from rural areas into every large city such as Beijing, Shanghai, and Guangzhou. Were the democracy movement to mobilize such people, the situation could become uncontrollable. While the unification of Germany has caused unemployment problems, it should be remembered that former East Germany had a population of only 17 million people. If China's industrial reserve army of 200 million were to move to the

cities or abroad, the situation could not be controlled and no government, Chinese or otherwise, would be able to deal with it. It is therefore necessary for the Chinese government to retain its policy on birth control even though it has been accused of violating human rights.

Sixth, in the 1980s the former Soviet Union and Eastern Europe were beset by a low or minus growth rate of the economy. On the other hand, China has achieved the very impressive annual growth rate of 10 per cent during more than ten years of economic reform and open economy. Chinese stores now offer a wider selection of foods and consumer durables than before. The important difference between Russia and China is that China has 4 million Chinese and 20 million foreign citizens of Chinese origin living abroad. Many overseas Chinese have stepped in to invest their money in China. In particular this has pushed the development of the South China Economies which has come about mainly because of the economic cooperation the mainland has received from Hong Kong and Taiwan. Thanks to its reform and open-door economic policy, China has managed to accelerate its economic development and to raise the people's standard of living.

Democracy as it is occurring in the former Soviet Union and Eastern Europe represents a historical necessity. Democracy as an institutional framework is superior to dictatorship. However, the existing democratic systems in Western countries do not necessarily function according to the ideal. Whether or not the instantaneous application of democracy and liberty is desirable for China is much more difficult to determine at this stage. Given the existing circumstances in China the only feasible way forward would be to carry out a gradual reform, conducted through measures designed to minimize the contradictions and conflicts that inevitably attend the transitional period China is experiencing.

### *Composition of This Book*

The Chinese economy is undergoing structural changes in the following three directions.

First, in the process of modernization, rapid changes have occurred in the Chinese economic structure which are occurring in many developing countries. The agricultural reforms promoted by Deng Xiaoping since the late 1970s have sent the waves of the commodity economy rippling into the rural areas.

Also changing is the Chinese industrial structure, with economic emphasis shifting from primary to secondary, and then to tertiary industry. Simultaneously, population movement from rural to urban areas has been accelerated.

Second, changes similar to what happened in Eastern Europe and the Soviet Union have occurred in China. As in the first two there is a transition from a centrally controlled economy to a market economy. Bureaucrat brokers have been rampant in pursuing their interests exploiting the differentials between the official and market prices. But if prices are fully liberalized, inflation will gallop. China thus has come to have a multi-layered economic structure where the

state sector based on the principles of planning, foreign ventures and rural small enterprises following market principles, and the traditional rural sector exist side by side, increasing the conflicts and contradictions among them.

Third, China is shifting from a closed to an open economy. China abandoned its closed policy and opted for an open economy by establishing special economic zones and economic technology development zones and by enacting joint venture laws to induce foreign investment. The outcome has been the concentration of human, material, and financial resources in coastal areas and away from inland areas. The economic gap between the two has thus been widened further.

Of the three dimensions where changes are taking place in China, this book focuses mainly on the second, namely, the shift from a planned to a market economy.

Chapter 1 empirically traces how the economic ideal and the real administrative and centrally managed economic system began to diverge during the pre-reform 1970s. It identifies the necessity of economic reform and the orientation of this reform since it was launched toward the end of the decade.

Chapter 2 examines the relationships between the plan and the market in China by differentiating "materials" and "commodities" and clarifying the characteristics of the respective methods of management.

The launching of economic reform brought to the surface the inflationary pressure that had been latent over the years and Chapter 3 will elucidate the mixed inflationary factors (demand-pull, cost-push, and money supply) that have simultaneously been at work to produce the recent inflationary tendency.

Chapter 4 traces the course of economic reform and open-economy policy since the late 1970s. The behavior of state-owned enterprises has been distorted by the failure of the original market-oriented reform because of galloping inflation, while a decentralization-oriented reform has continued to proceed. It will not be easy for Chinese economic reform to get out of the current impasse, but we shall discuss what economic model China is aiming at in the future.