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Reorientation of Economic Reform and Medium- and Long-term Perspectives

Introduction

As was explained in Chapter 1, the Chinese economic reform and its goals were conditioned by new economic developments that had the momentum of breaking up the old institutional framework. The reform was composed of two major factors—expansion of decision-making powers for enterprises and local governments on the one hand and introduction of the market mechanism on the other hand.

In this chapter, I examine how economic reform has evolved, and, in particular, how the reform shifted from an acceleration phase to an adjustment phase. I will then look into the mechanism that generated irregular behavior by state-owned enterprises when the reform came to a standstill. Lastly, I will examine the medium- and long-term perspectives of economic reform and discuss what market economy model China is hoping to adopt.

The Trajectory of Economic Reform

Three Stages of Reform

Around the end of 1978 when the Third Plenary Session of the 11th Central Committee of the Communist Party of China was held, China began making efforts to depart from the Mao Zedong system by adopting economic reform and an open-door policy. More than a decade has passed since China began to implement this policy. During this time, the Chinese government has carried out a number of decrees and laws for reform, and new reform measures have

also been taken by enterprises and local governments. The main measures taken in this direction are chronologically shown in Table 4-1. Economic reform until 1988 can be broadly divided into the following three stages.

The first stage (December 1978–October 1984)

The emphasis of reform during this period was on rural areas. People's communes maintained over the previous two decades were dissolved and divided into administrative organizations (*xiang* or township) and economic organizations (production teams and rural industrial enterprises). The collective management of production teams was replaced by household management of production. The latter form of management spread to more than 90 per cent of the farming households by the end of 1983.

Reform measures were taken in urban areas, too, mainly to transfer powers formerly in the hands of the central government to enterprises and local governments. Chief among these measures was the introduction in February 1980 of the profit-retention system for enterprises and the contract system for fiscal revenue and expenditure between central and local governments. In some major cities, integrated reform measures were experimented with to the areas within their jurisdictions.

The second stage (October 1984–October 1987)

The reform entered its second stage following the Third Plenary Session of the 12th Central Committee of the Communist Party of China held in October 1984. This meeting adopted the "Decision of the Central Committee of the Communist Party of China on reforming the economic system" which characterized the future economic system of China as "a planned commodity economy under public ownership." What this meant in real terms was:

(a) the further development of a commodity economy under socialism meaning a planned "commodity economy" and not a "market economy" reliant exclusively on market regulation;

(b) however, some agricultural and subsidiary products, daily sundry goods and services would be left to market regulation free from the control of planning. Market regulation thus would play an auxiliary role in the national economy;

(c) the planned economy would be subject to both "mandatory planning" (based on administrative decrees) and "guidance planning" (based on inducements and other non-mandatory measures); and

(d) the scope of mandatory planning would be gradually reduced and that of guidance planning gradually expanded.

This decision unambiguously provided for a set of policies conducive to the development of a commodity economy under socialism and would accelerate marketization of the economy, but with the proviso that this would not mean introduction of a total "market economy" dependent on market regulation. In

TABLE 4-1
POLICIES AND MEASURES ON ECONOMIC REFORM AND THE OPEN DOOR

The first period of reform and open-door policy

1978	Dec.	The Third Plenary Session of the 11th Central Committee of the Communist Party of China; the decision to accelerate the development of agriculture
1979	June	The Second Session of the 5th National People's Congress; the adoption of an open-door policy
	July	Five documents on the reform of the management system in state-owned industrial enterprise.
	July	The Law of the People's Republic of China on Chinese-Foreign Joint Ventures
1980	Feb.	Reform of the fiscal system, setting down the resources of revenue for the central and local governments.
	Feb.	Experimenting with a profits-retention system for state-owned industrial enterprises.
	Aug.	Regulations on the Special Economic Zones in Guangdong Province.
	Nov.	Loans for capital construction by the People's Construction Bank of China.
1981	Jan.	Many agreements for the import of plants from Western countries were canceled.
	Oct.	The national working conference on the rural districts, upholding the variety of responsibility systems for production.
1982	Apr.	The dismantling of the People's Communes (separating the administrative unit and the economic organization) is incorporated into the Constitution.
	May	The State Commission for Restructuring the Economic System is established (the presiding minister is Zhao Ziyang).
1983	Jan.	The plan for forming seven economic blocs.
1984	Apr.	The open-door policy is applied to fourteen coastal cities and Hainan island.
	May	Provisional regulations on further extending the decision-making power of the state industrial enterprises.
	Aug.	The regulation concerning the improvement of the planning system.

The second period of reform and open-door policy

1984	Oct.	The Third Plenary Session of the 12th Central Committee of the Communist Party of China; the decision on reforming the economic system.
1985	Jan.	Abandonment of the policy of state monopoly for the purchase of grain and adopting the policy of purchase by order.
	Feb.	The open-door policy is applied to three delta zones.
	May	The abolition of state-determined prices for meat, fish, eggs, vegetables, and fruits. (At the end of 1985 the state-controlled prices for these items were reintroduced)
	Sept.	The regulation concerning the energizing of state-owned large and medium-sized enterprises.
1986	Mar.	The regulation concerning the acceleration of horizontal economic combinations between enterprises.
	Mar.	The policy concerning economic reform during the period of the Seventh Five-Year Plan (1986-90).
	Apr.	The law on enterprises owned by foreign capitalists.
	Aug.	The abolition of state-determined prices for monochrome television sets, refrigerators, washing machines, and others.
	Sept.	Adoption of the contract system for employing new laborers, and promulgating regulations concerning the dismissal of employees and unemployment insurance.
	Oct.	Three regulations concerning the management of state-owned enterprises, including the regulation on the systems of factory director's responsibility.
	Dec.	The law for the bankruptcy of state-owned enterprises.
1987	Oct.	The open-door policy is extended to Shandong Peninsula and Liaodong Peninsula.

TABLE 4-1 (Continued)

<i>The third period of reform and open-door policy</i>		
1987	Oct.	The 13th National Congress of the Communist Party of China recognizes the present stage of China as the primary stage of socialism, and permits the existence of private enterprises.
1988	Apr.	The 7th National People's Congress adopts the Law concerning state-owned industrial enterprises and the strategy for developing of coastal districts.
	May	The re-abolition of the re-controlled prices for non-staple food.
	Aug.	The preliminary program for price and wage reform.
<i>The adjustment policy</i>		
1988	Sept.	The Third Plenary Session of the 13th Central Committee of the Communist Party of China adopts the adjustment policy.
1989	Jan.	Controls over prices by local governments is restored in most regions.
	June	The Tian-anmen incident and the start of economic depression.
	Aug.	The plenary session of the State Council declares the stability of prices, the promotion of agricultural development, the reducing of investment, and the restriction of wage increases as the main points of the adjustment policy.
1990	Feb.	Revision of the adjustment policy toward stimulating the market.
	Apr.	Presentation of the development program for Shanghai Pudong new district.
1991	Mar.	The general outline of the Eighth Five-Year Plan and the ten-year program for developing the national economy and society; both call for accelerating reform and the open-door policy during the latter half of the 1990s.
	May	The second version of the regulation of 1985 concerning the energizing of state-owned large and medium-sized enterprises.
	Sept.	The Central Committee of the Communist Party of China Working Conference declares the end of the adjustment policy.
<i>The fourth period of reform and open-door policy</i>		
1992	Jan.	Deng Xiaoping's visit to South China accelerating reform and extending the open-door policy to inland cities. By June 1992 the open-door policy had been applied to 28 cities and 8 prefectures along the banks of the Changjiang River and 13 border cities in the Northeast, Southwest, and Northwest. In August inland provincial capitals such as Zhengzhou, Taiyuan, Xi'an, Lanzhou, Xining, Yinchuan, Harbin, Changchun, Huhehaote, and Shijiazhuang were added to this line.
	June	Top leaders as well as reformist scholars propose forming "the socialist market economy."

Source: Prepared by the author based on his research, Kyōichi Ishihara et al., *Chinese Economy under the Adjustment Policy*, JRP Series 91 (Tokyo: Institute of Developing Economies, 1991), pp.12-13, and *Remmin ribao*, July 17 and August 14, 1992.

this, the decision marked a definite departure from the traditional socialist model.

Since that decision, economic reform has shifted emphasis from rural to urban areas. Waves of reform policies began to spread to micro- and macro-levels directed at the main systems including planning, production, distribution, finances, prices, labor, wages, trade and so on. In rural areas, the compulsory procurement system of agricultural products was replaced by the system of purchases through markets. Central to this change was the replacement of the state monopoly for purchases of grain with a system of contracted purchases on order of the state.

The third stage (October 1987–September 1988)

In his report to the 13th National Congress of the Communist Party of China held in the autumn of 1987, Zhao Ziyang hammered out a clear policy of further stepping up the reform and open door line.¹

According to Zhao's report, China was at a historical stage defined as the primary stage of socialism. This has a dual meaning: on the one hand China is still a socialist society based on public ownership of means of production, but on the other hand, given the low level of productive forces and immaturity of commodity economy, China will require a long time, at least the period to the year 2050, to achieve industrialization and modernization.

Having thus defined the historical stage China was at, Zhao proposed the following six points as essential to the economic reform:

(1) State-owned enterprise activities should be energized through the separation of management from ownership. For this, independent accounting of enterprises, the system of factory director's responsibility, and management responsibility should be promoted. Also, the joint stock system should be recognized as a form of asset management of socialist enterprises and continue to be experimented with.

(2) Horizontal economic combination among enterprises should be developed beyond administrative barriers. Large and medium-sized enterprises producing quality goods should be the cores of economic combination. Enterprise groups should pursue advantages of specialization and economies of scale. Also, the economic zones played a leading role by cities should be encouraged to be formed.

(3) The temper for fostering socialist market systems should quicken. Markets should be formed not only for production and consumption goods but also for capital, services, technologies, information, and real estates.

(4) The financial and fiscal systems should be reformed to strengthen leverages to control macro economy.

(5) While retaining the state and collective ownership systems as the core, other forms of ownership should also be developed, including *hezuo jingji* (cooperatives paying dividends in accordance with investment shares), *siying qiye* (private enterprises employing many wage workers), and self-employed businesses.

(6) While keeping distribution in accordance with labor as the basis, other distribution systems should also be carried out. Thus legalized were interest revenues, stock dividends, and "unearned incomes" accruing to private enterprise owners.

The most important point of Zhao's report was his definition of the primary stage of socialism which legalized the presence of private enterprise and justified stock dividends and profits earned by private entrepreneurs. Whether such diversity in ownership should be tolerated only at the primary stage of social-

ism or should be accepted at further stages was still being debated. Dong Fureng, then director of the Institute of Economics under the Chinese Academy of Social Sciences, argued that diversity in ownership should exist even after the primary stage.²

The 13th Congress report also raised the issue of political reform, and proposed a series of reforms in order to do away with negative aspects of excessive concentration of power, bureaucratism, and remnants of feudalism.

The Seventh People's Congress held in the spring of 1988 adopted the law concerning state-owned industrial enterprises and sent into force the law for the bankruptcy of state-owned enterprises. Also limelighted was the strategy for the development of coastal districts. This encouraged foreign firms to invest in these districts.

Shift to Adjustment Policies (September 1988–December 1991)

In 1988 China achieved high growth rates, 11.0 per cent in GNP growth and 20.8 per cent in mining and manufacturing growth. In the meantime, the consumer price index soared 20.7 per cent and the major producer-goods sales price index 21.5 per cent. Inflation galloped. That year, the national policy also had to change. In the first half of the year the reform and open-door package was promoted but in the second half the policy had to be switched to one of austerity and adjustment.

After the price freeze period of the 1988 Spring Festival was over, the prices of industrial products for daily use were raised one after another in Shanghai, Nanjing, Wuhan, and Beijing. In May a rise in prices of non-staple food was announced in urban districts. The prices of pork, beef, eggs, refined sugar, and vegetables jumped 30–60 per cent in Beijing. Postal fees and taxi fares were raised in June and cigarette and alcoholic drinks prices followed in July.

From May through July, Deng Xiaoping, Zhao Ziyang, and other top leaders made the point on all available occasions that the price and wage system reforms should be carried out by all means. The August meeting of the Central Committee's Political Bureau adopted "the primary program concerning price reform and wage reform."

Such statements by the leadership and the rush for price-hikes caused social unrest. Toward the end of August citizens and farmers rushed to shops for hoarding. Banks had a run. The Industrial and Commercial Bank of China lost personal deposits by 2.3 billion yuan in the single month of August.

As the public was seized with a panic, the leadership toned down their reform and open-door pronouncements. The Executive Meeting of the State Council held at the end of August adopted an urgent decision on price policy and market stability, postponing price reform. The Third Plenary Session of the 13th Central Committee of the Communist Party of China held at the end of September decided to shift the emphasis of economic management in the two following years onto "the improvement of the economic environment and

rectification of the economic order.” This marked China’s shift to adjustment. Though austerity and adjustment policies had been temporarily enforced in 1981 and 1986, the adjustment this time turned out far more drastic, causing industrial output and sales to drop the most sharply ever.

After the suppression by the army of the Tian-anmen demonstration in June 1989, the austerity program was further stepped up. The term of adjustment was elongated from the originally planned two years to three years (1989–91) or more. Prime Minister Li Peng proposed three major adjustment policies at the Plenary Session of the State Council held in August.³

The first is that the emphasis of the price policy should be on stability of the prices of daily necessities for consumption by medium- and lower-income groups. The second is that much more efforts should be made to ensure enough supply of producer goods for agriculture and to make available enough funds for the purchase of agricultural products so as to help farmers achieve good harvest. The third is that investment in fixed capital formation should be reduced in order to suppress gross demand. Wages and collective consumption by units should be held low. Taxation should be strengthened in order to rectify unfair distribution.

The adjustment policy has been partially successful in the suppressing of inflation, mostly owing to the sudden decline of demand for consumption goods caused by the Tian-anmen incident. However, a look at economic management as a whole shows that the serious problems have not been resolved. According to the report of the fourth session of the National People’s Congress by Zou Jiahua, Minister of the State Planning Commission, the difficulties facing the Chinese economy are comprised of the following components.⁴

First, many state-owned industries, in particular the large and medium-sized enterprises, have fallen into deficit. Second, the economic cycle remains abnormal, in the process of industrial production recovery, some products have been selling poorly while inventories have been growing, obstructing the normal cycle in the economy as a whole. Third, no progress has been made in the adjustment of the economic structure and economic efficiency has actually dropped. Fourth, the fiscal deficit has swelled.

In March 1990, the course of the retrenchment program was altered and the economy gradually turned towards recovery.⁵ At last even Prime Minister Li Peng was obliged to declare an end to the adjustment policy in September 1991.

Achievements in Enterprise Reform

The Three Aspects of Enterprise Reform

China’s enterprise reform program has involved three aspects—reforming the relationship between the government and enterprises, reforming the relationship between enterprises, and reforming intra-enterprise relationships.

Regarding the first, the reforms intended to reduce to a minimum government regulation and control over enterprises, the purpose being to give them discretionary powers over production, marketing, and investment. In 1988 "The law concerning state-owned industrial enterprises," "The law for the bankruptcy of state-owned enterprises," "Regulations on the contract management responsibility system," and "Regulations on the lease management of state-owned enterprises" were enacted to facilitate enterprise reform.

The contract management responsibility system is now applied to most of the state-owned enterprises. This system represents a less radical reform than a corporate income tax system that was the objective to be accomplished in the mid-eighties. It does however represent a new approach compared with the pre-1978 enterprise system, and the contract system introduced a new mechanism into Chinese enterprise management.⁶

Under this system, for instance, the principle of competition began to function, even if only partially, in Chinese enterprises. In 1988, 35.5 per cent of state-owned enterprises contracted for quotas through competitive bidding. In cases where the contracted quotas are not fulfilled, the system calls for the risk to be borne by the top manager, by management as a whole, or by the employees as a collective. This risk-taking system is currently applied to 25 per cent of the Chinese state-owned enterprises.

Regarding reform in inter-enterprise relationships, enterprise mergers have been encouraged. A total of 2,856 enterprises absorbed 3,424 other enterprises in twenty-seven provinces and municipalities. Aside from such enterprise mergers, partnerships and tie-ups are being promoted among enterprises which are compatible in technology, production, and marketing. By the end of 1988, 1,362 enterprise complexes were thus established in eighteen provinces and municipalities. Of them more than 100 are large complexes.

Reform measures have also been taken on a trial basis in intra-enterprise relations. The system of giving responsibility to the factory director was being applied in 95 per cent of the state industrial and commercial enterprises by the end of 1988.

Employee wages have also been linked with the quota system whereby wages are determined by the extent that contracted quotas (norms) are achieved. Quotas (norms) are set in accordance with various factors specific to each enterprise. The kinds of quotas linked with total wage are the profits earned, profits turned in to the state, taxes, output, sales, work volume, and foreign exchange earnings. The system of determining the total wage in this manner was introduced into more than half of the state-owned enterprises by the end of 1988.

Reform in the employment system was also introduced on a full scale in the autumn of 1988. New workers are thus no longer hired as life-time employees but are hired on a contract basis. The number of contract workers in 1988 reached 9,920,000 persons, or 10 per cent of all state-owned enterprise employees.

Labor-force rationalization was also launched. Thirteen million employees at thirty thousand of the state-owned enterprises, 13 per cent of all state-owned enterprise employees, were transferred to new positions or otherwise reorganized into labor groups which were newly set up to be the basic units of the contract responsibility system.

It should be pointed out that labor-force rationalization is the most difficult part in intra-enterprise reform, for in the presence of large unemployment, dismissed workers can hardly hope to find alternative jobs. There are 11–12 million new job seekers each year. In 1988, government agencies and state-owned enterprises employed 4,920,000, and collective enterprises in the cities employed another 2,630,000, thus giving employment to only 7,550,000 new job seekers. Most of the remaining job seekers found employment as peasants, at small enterprises in rural districts, or were self-employed. When a state-owned enterprise dismisses workers, the first fired are extra-plan workers (temporary workers). They do dirty, hard, and inferior (*zang, lei, cha*) jobs that regular workers do not want to do.⁷ There is a total of 13 million such workers. If they are dismissed, few regular workers would refuse to take over their jobs.⁸

Performance of Mining and Manufacturing Enterprises

The above-mentioned enterprise reforms, coupled with other economic reforms, have contributed greatly to the development of Chinese economy since 1979. Let us take a look at the achievements made by mining and manufacturing enterprises in the ten year period from 1979 through 1988.⁹

In material terms, the output of coal, crude oil, iron and steel, chemical industrial materials, construction materials, machines and equipment, textiles, and twenty-four other items increased 2–4.5 times between 1978 and 1988. In value terms, mining and manufacturing output continued to grow at an average annual rate of 11.1 per cent in the same ten years. The output of state-owned enterprises whose growth was slower than that of the other sectors also achieved an annual growth of 8.2 per cent in the same period. Their sales increased faster at an annual rate of 11.5 per cent. Profits earned by the mining and manufacturing sector also increased 9.7 per cent annually. Profits earned by state-owned enterprises registered an annual increase of 7.6 per cent.

Improvements were also seen in economic efficiency. The norm of materials consumption per unit of product improved between 1978 and 1988 for sixty-six of the ninety-three products produced by major mining and manufacturing enterprises. Labor productivity also climbed 5.1 per cent per annum during the same period.

But not all economic efficiency indicators at the enterprise level improved. The cost-profit ratio, fund-profit ratio, sales-profit ratio, and the rate of cost reduction deteriorated.¹⁰ This reflects slow progress in technological innovation.

Chinese enterprise reform thus has brought about significant improvements

in institutional aspects as well as enterprise performance. This should be clearly recognized in evaluating China's economic reforms and open-door policy. It is also true however that progress has been slow with regard to labor force rationalization and economic efficiency. As with the reform program as a whole, Chinese enterprise reform now faces serious troubles, forcing a review of what has been done. In the pages that follow, I deal with contradictions in the enterprise reform program, situating them in the context of the general trend in the China's economic reforms.

The Extension of Enterprise Powers

The Two Lines of Reform

The reform of the Chinese economic system undertaken since the end of the 1970s has followed two main lines as mentioned in Chapter 2. One is the introduction of the market mechanism. Setting production goals by directives, traditionally the chief method of administrative control, has been reduced and largely replaced by resource allocation through economic means such as prices, interest rates, and taxes. The reform measures taken along this line were intended to liberalize prices from government controls and encourage the formation of markets for producer and capital goods, finances, and labor. Particularly important were commercial and price reforms. This was the key to the whole reform program that rested on the introduction of the market mechanism.

But it was precisely in this area that the reform program met a number of serious problems and had to be slowed as it entered the implementation stage. Lifting of price controls threatened to cause inflation. Under the multiple price system under which government-determined, government-guided, and market prices coexisted, the opening of producer- and capital-goods markets facilitated rampant black-marketeering of government-controlled goods by bureaucrat brokers. The formation of a labor market has also been difficult given the vast amount of unemployment population including disguised unemployment.

Chinese fiscal and financial reforms involved a shift from coercive administrative control over all types of financial operations to a "window guidance" type of control based on moral suasion.¹¹ But conditions are not ripe for the formation of a unified financial market. When financial markets exist only locally, it is difficult to fully and effectively apply the orthodox financial control methods composed of official discount rate policy, open market operation, and reserve requirements policy. The recent expansion of credit in China is largely a product of this contradiction specific to a transitional period.

The other line pursued in economic reform is decentralization of decision-making powers to enterprises and local governments. This centers on the expansion of autonomous management powers of enterprises. There being little resistance to decentralization, reform progressed fastest in this area. But slug-

gishness in market mechanism introduction has influenced the course of decentralization.

The Three Stages of Enterprise Reform

Expansion of enterprise powers is central to China's decentralization reforms. From 1978 through 1986, enterprise reform was successfully carried out through the following three stages.¹²

The first stage was from October 1978 through 1980 during which an enterprise fund system was experimented with at state-owned enterprises. Under this system, the enterprise would retain 3–5 per cent of the total wage amount in accordance with the degree of fulfillment of production, quality, profit, and cost goals. The enterprise fund thus created was to be appropriated for welfare benefits and bonuses for the employees. By the end of 1980, 6,600 enterprises, or 16 per cent of manufacturing enterprises covered by the national budget, were following this system on a trial basis.

The second stage was from the summer of 1981 through early 1983. During this stage a contract profit-delivery responsibility system was introduced into manufacturing enterprises. Those enterprises which had fulfilled the contracted quotas were allowed to withhold part of the profits. This system was adopted by 36,000 enterprises by the end of 1981.

In the third stage that ranged from 1983 through 1986, a corporate tax system was introduced on an experimental basis. In June 1983 state-owned enterprises began to pay corporate income taxes instead of delivering profits to the government. This was the introduction of the first version of the corporate tax system. The tax rate was 55 per cent for large and medium-sized enterprises, and eight categories of progressive rates were set for small enterprises. Of the after-tax profits, portions were paid to the government in the form of contracted profit transfer and adjustment tax, and the remaining portions were withheld as reserve funds. In actual cases, corporate taxes coexisted with the traditional profit transfer at the first version of the third stage.

The second version of the corporate tax system was introduced in October 1984. The new system abolished direct profit transfer in favor of corporate taxes as the single form of profit transfer to the government. The business consolidated tax (levied on the sales revenue gained by each enterprise belonging to the mining, manufacturing, commerce, trading, transportation, or service industries) was abolished and divided into a commodity tax (*chanpin shui*), value-added tax (*zengzhi shui*), salt tax (*yan shui*), and sales tax (*yingye shui*), levied according to business categories. Simultaneously, the land use tax and the city maintenance and construction taxes were introduced.

China's enterprise reform effort was geared to provide incentives to an enterprise by linking the amount of internal reserves it could withhold to its achievements. In this sense the unification of corporate tax systems was understood to be one of the final goals in the reform program, for under this system the

enterprise would break free from the administrative controls of government offices there by securing its after-tax profits for use at its own discretion.

Reemergence of the Contract Management Responsibility System

Though the unification of corporate tax systems was considered one of the final goals of enterprise reform, it was clear that in the Chinese situation the tax system would not play its expected role because its function would be impeded by the skewed price system. Under the existing Chinese economic system, the amount of profit earned by an enterprise is determined not so much by the quality of management as by whether the government-set price of its products is high or not. In fact, the unbalanced price system set by the government is causing raw materials and energy industries to register losses while ensuring high profit rates for processing industries.

When a uniform tax system is applied to all enterprises where prices are irrationally set and a competitive market environment is absent, the inevitable outcome is growing income gaps among enterprises subject to different external conditions. Such income gaps generated by unequal competitive conditions (*ku-le bu jundeng*—the phenomenon of sufferings and blessings not equally shared) must be rectified. For this reason, the idea of uniformly applying the corporate taxes had to be abandoned. Instead, a regulatory income tax was introduced to complement the corporate taxes and to mitigate inter-enterprise differences in after-tax profits. Administrative interference by government offices has thus been called back in at the cost of the original idea of uniform corporate taxes.¹³

The enterprise reform program entered its fourth stage at the end of 1986. This stage was marked by the reintroduction of the contract management responsibility system. In that year the government intended to fully revise the prices of producer goods, but had to give up its price reform plan as inflation which had started in the previous year began to gallop.¹⁴ While efforts to set equal competitive conditions for all enterprises failed, reform measures to increase enterprise powers were still continued. But if all enterprises had the same degree of autonomous powers when their external conditions were unequal, they would certainly suffer from unfair income distribution. In order to prevent this, the government offices in charge would have to regulate the powers of enterprises in accordance with the latter's respective business situation and external circumstances.

It was to meet this requirement that the contract management responsibility system was reintroduced. This system is basically the same as the contract system practiced during the second stage of reform (1981–83). Indeed it marked the reform's return to the second stage. In 1988 this system was applied to more than 90 per cent of the state industrial and commercial enterprises all over the country, and 95 per cent of the large and medium-sized state industrial enterprises.¹⁵ The new contract management responsibility system is subdivided into

TABLE 4-2
ENTERPRISE MANAGEMENT RESPONSIBILITY SYSTEMS IN JILIN PROVINCE, 1987

	(%)
Contracting for quotas of taxes and profits transferred to the government (the above-quota portions are shared in proportion to the contracted distribution ratio)	8.5
Contracting for progressive increase in taxes and profits transferred to the government (same as above)	8.0
Contracting for taxes and profits transfer and technological innovation	0.3
Contracting for transfer to the government of fixed amounts of taxes and profits (the overfulfilled portions are retained by the enterprise)	51.3
Linking the increment in taxes and profits transfer with the total amount of wages	4.1
Contracting for certain amounts of profits in standard years (overfulfillment entitles the enterprise to a lower income tax rate)	2.2
Contracting for a definite amount of output: this applies to enterprises generating little loss or profit (no transfer to the government and no subsidies)	10.5
Contracting for a definite amount of loss or progressively decreasing loss	7.5
Taking full risks for management	2.1
Others	1.5
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Total enterprises to which contract management responsibility systems are applied	96.0

Source: Du Haiyan, "Chengbaozhi: guoyou qiye tizhi gaige de chushi xuanze" [The contracted system: an initial choice in reforming the state-owned enterprise system], *Jingji yanjiu*, 1987, No.10, p.10.

Note: Percentages shown are of the total number of centrally and locally controlled enterprises in the province.

several categories as explained in Chapter 3, The Contract Management Responsibility System.

Vicious Cycle

In Jilin Province which has developed the contract management system more widely than any other province, ten versions of this system are followed as Table 4-2 indicates. The system in Jilin Province suffers from the following problems.¹⁶

First, the contract term is too short, only one year for two thirds of the enterprises. This makes enterprise behavior myopic.

Second, the contract norms are individually agreed upon by each enterprise and the government agency in charge. Consequently, the retained profit amounts vary greatly from enterprise to enterprise, the gap between the largest and smallest even reaching fifteen million yuan or so. The differences moreover do not reflect the good or bad quality of the management but the good or bad bargaining ability of the enterprise vis-à-vis the government agency.

Third, bonuses are increasing. At profitable enterprises the annual bonus has reached the allowable ceiling of 4.5 months regular pay. Ten major enterprises in the province have accumulated bonus funds totaling 7.5 million yuan, which are waiting for the additional disbursement to be permitted.

Fourth, investment in other industrial areas is barred as each enterprise must

confine its activities to the business area defined by the contract it has with the government agency in charge. This practice hampers necessary industrial restructuring.

Fifth, the cost of activities and mechanisms required for intra-enterprise monitoring and bargaining with other bodies and individuals has increased greatly. At the Changchun Automobile Plant, forty units comprising 351 persons had to be organized simply to check whether the contract norm was being fulfilled as planned.

Under the contract management responsibility system, a production norm is set for each individual enterprise in accordance with its business performance and the given price level. In setting the norm, *taojia huanjia* (bargaining) between the enterprise and the government agency in charge carries the greatest weight. A manager's worth is tested in this bargaining: an able manager is one who succeeds in bargaining a low contract norm.

Therefore the size of retained profit depends not so much on whether an enterprise's business performance is good as on the bargaining power it can wield.¹⁷ The enterprises chronically registering losses have no potential for profits. In their case they contract to reduce their losses to a promised level. If they succeed in overfulfilling this loss reducing norm, the difference is retained by them.

No matter whether in the black or in the red, the enterprise thus can increase internal reserves. Table 4-3 shows the shares of retained profits out of the total profits generated by state-owned enterprises. As is clear from the table, the shares began to increase rapidly after reforms were launched in 1978.

As mentioned in Chapter 3, the contract management responsibility system is a product of compromise amongst all the economic bodies involved. However, from the point of view of thorough economic reform, this system is far from satisfactory as it does not modify the fundamentals of the traditional system.¹⁸ The enterprise remains subjugated to administrative agencies. Even if an enterprise continues to suffer losses over years, it not only does not go bankrupt but can continue to pay the same wages and even bonuses.

People are still eating "a big pot of rice" (*daguo-fan*) from the "iron rice bowl" (*tie-fanwan*), having no fear of losing privileges. Budget constraints on enterprises still remain soft. This is why the contract management responsibility system is often characterized as a "reform that has not modified the benefit allocations under the traditional system."¹⁹

Already in 1980, Xue Muqiao pointed this out in his treatise on the "vicious cycle."²⁰ According to him, the complicated formula giving government agencies in charge powers to determine the profit retention rates for individual enterprises presupposed irrational relative prices of commodities and thus in the end impeded progress in price reform (Figure 4-1).

As government activity reports have repeatedly admitted since the early eighties, introduction of the market mechanism centering on price reform is the key

TABLE 4-3
PROFIT RETENTION RATES AT STATE-OWNED ENTERPRISES (AMOUNT OF PROFIT
RETAINED / TOTAL PROFIT EARNED)

	1952-57	1958-61	1978	1979	1980	1982	1983	1984	1985	1986	1987	1988
State mining manufacturing, and transport enterprises (A)		10.3	2.0	7.6		21.1	26.3	30.1	37.9			
State mining and manufacturing enterprises (B)			3.7							42.4		
State mining and manufacturing enterprises (C)					10							
State mining and manufacturing enterprises (D)										33.1	33.7	36.3
State-owned enterprises (E)	3.6				22.27 ^a				28.9			

Sources: For (A), Dangdai-Zhongguo-shuangshu-bianjibu ed., *Dangdai Zhongguo caizhong* [China today: finance (II)], (Beijing: China Social Sciences Publishing House, 1988), pp. 9-15; for (B), Xu Feiqing ed., *Zhongguo jingji tizhi gaige* [China's economic structure reforms], (Beijing: China Financial and Economic Publishing House, 1988), p.158; for (C), Yuan Shouqi, *Chengbao jingying zerenzhi* [Contract management responsibility system], (Beijing: China Economic Publishing House, 1988), p.13; for (D), State Statistical Bureau, ed., *Zhongguo gongye jingji tongji nianjian, 1988*, [Industrial economic statistical yearbook of China, 1988] (Beijing: Zhongguo-tongji-chubanshe, 1988), and idem, *Zhongguo tongji nianjian* [Statistical yearbook of China] (Beijing: Zhongguo-tongji-chubanshe), 1986-89 editions; and for (E), Dong Dalin. "Zhongguo jingji tizhi gaige shinian jianshu" [Brief description of Chinese economic system reform during the past decade], *Zhongguo jingji tizhi gaige*, 1989, No.2, p.12.

Notes: (Total profit earned) = (crude enterprise income) - (cost) - (transaction tax) - (appropriated fund repayed to the state finances) = (profit turned over and income tax) + (loan repayment) + (retained profit).

^a (Retained profit) / (total profit after settlement).

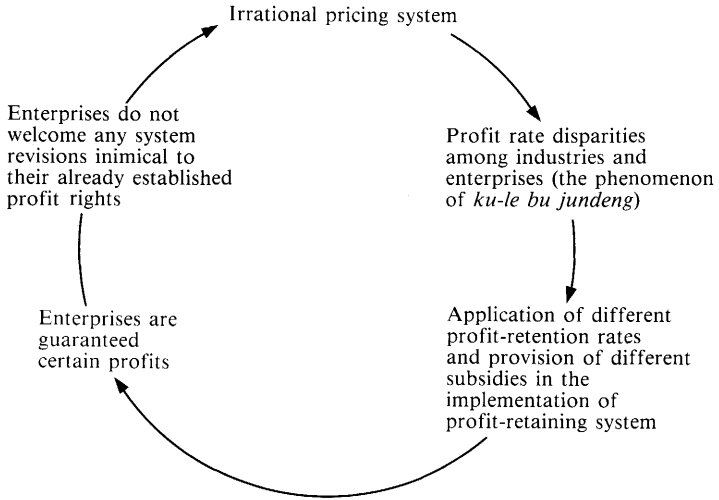
to economic reform. Nevertheless, it would be premature to carry out price reform across the board when gross demand still largely exceeds gross supply. To carry out such reform now would kick off inflation and invite social turmoil. On the other hand, preserving the present irrational price system will keep the decentralization reforms in the strait jacket of the traditional system.

The Market Mechanism Does Not Function

Market-oriented Reform

When the market mechanism functions normally, prices go down if supply exceeds demand and go up if demand exceeds supply. Reacting to price fluctu-

Fig. 4-1. Vicious Cycle Plaguing Reforms in Distribution



Source: By the author.

ations, individual enterprises and households adjust their supply and demand volumes. Market equilibrium is attained through these barometer and parameter functions of price, and the patterns of resource and income distribution are also determined accordingly.

As was earlier said, Chinese economic reforms since the end of 1978 purport expansion of enterprise autonomy and introduction of the market mechanism. In other words, the reforms aim at creating a situation where macroeconomic equilibrium is attained as the result of competition among individual enterprises acting to maximize their respective profits. The wages and fringe benefits of the employees are to be linked with the amount of profits their enterprise obtains. But for such a system to function more or less smoothly, a fair competitive environment should first be provided to enterprises. It is therefore logical that price reform to adjust relative prices and abolish the officially determined prices should have emerged as a crucial policy task. Obviously under an irrational and inconsistent price system, profit-rate gaps are bound to develop among industries and enterprises irrespective of their performance. Fair competition cannot take place under such circumstances.

To be sure the reform efforts to decentralize the economy and introduce the market mechanism have marketized the Chinese economy to a remarkable degree. The weight of government-determined prices in the sales of various goods is rapidly diminishing, giving way to government-guided prices (fluctuating wi-

thin government-designated margins) as well as market-adjusted prices. Reflecting different degrees of government intervention and market adjustment, the same commodity thus has come to have more than one price, a phenomenon known as multiple prices.²¹

Expansion of the Non-commodity Economy

The diminishing weight of government-determined prices does not immediately mean full functioning of a market economy. Multiple prices obstruct fair market competition. The market-oriented reforms have on the one hand reduced the degree of government control, but on the other hand have not weakened and even strengthened trends in the non-commodity economy.

One trend is the increasing activity in the bartering of goods. China has been for years an economy suffering from shortages of goods. The introduction of the market mechanism of course has not eliminated this imbalance between supply and demand. Under these circumstances commodities whose demand is larger than supply sometimes function similar to hard currency. Table 4-4 gives exchange rates of various commodities against coal. These rates were set through consultations by the State Bureau of Materials and Equipment, the State Administration of Commodity Prices, the State Economic Commission, and the State Planning Commission. These rates are applied when a supply-side enterprise directly deals with a demand-side enterprise outside of the scope of planned distribution. Here commodity prices hardly function as a value indicator.

Even when there are market prices, bartering not based on money value is frequently carried out with commodities in short supply. Steel and aluminum are a case in point. The market price of steel is two thousand yuan per ton and that of aluminum ten thousand yuan per ton. But in actual practice, five tons of steel is bartered directly for one ton of aluminum. Money here fails to play its role as the general means of exchange.²²

Central government control has been curtailed, but this does not mean the diminishing of control itself. The State Planning Commission in 1988 gave mandatory production directives for only 60 kinds of mining and manufacturing products compared with 120 in 1984, and the share of goods under state control also declined from 40 per cent to 17 per cent of total mining and manufacturing output. However, in lieu of the State Planning Commission, other government agencies, both central and local, were giving the directives for norms to enterprises in their respective jurisdictions.²³ A survey made in 1984 (Table 4-5) showed that the share of mandatory planning increased as echelons went down from central to provincial and from provincial to municipal.

The State Council regulations promulgated in May 1984 imparted limited autonomy to enterprises in ten business categories including production, marketing, pricing, material purchasing, investment, personnel assignment, and wages. But the enterprises feel that they have been given but limited powers of management. Table 4-6 contains replies to a questionnaire on this matter sent to state-

TABLE 4-4
COAL EXCHANGE RATES WITH OTHER COMMODITIES

	Coal (Ton)		Coal (Ton)
Steel (1 ton)	11-20	Rubber (1 ton)	55-70
Zinc / aluminum (1 ton)	30-50	Urea (1 ton)	10-15
Lumber (1 cubic meter)	11-20	Barley (1 ton)	15-25
Sheet glass (1 standard box)	1.2-1.5	Rice / wheat flour (1 ton)	15-25
Soda ash / caustic soda (1 ton)	12-20	Bicycles (1 unit)	3.5-4
		Sewing machines (1 unit)	3.5-4

Source: *Jingji ribao*, November 19, 1983.

TABLE 4-5
PERCENTAGE SHARE OF PLANNING IN PRODUCTION

	Centrally Planned	Provincially Planned	Municipality Planned
Share of mandatory planning	12.44	21.51	23.97
Share of guided planning	9.48	29.12	26.91

(%)

Source: Zhongguo-jingji-tizhi-gaige-yanjiusuo-diaochazu, ed., *Gaige: women mianlin de tiaozhan yu xuanze* (Beijing: Zhongguo-jingji-chubanshe, 1986), p.53.

Note: One hundred per cent for total production volume; the provincially planned volume includes the centrally planned volume; and the municipality planned volume includes the provincially planned volume.

owned enterprise managers in Shanghai. As the replies show, few enterprises have full autonomous powers on planning, personnel assignments, finance, and pricing.

There are similar other data. The directives for norms the State Planning Commission gives to Shanghai cover only 18 per cent of the local mining and manufacturing output value. But a different picture appears if the situation is probed from the enterprise side. It is found that almost 100 per cent of the major products in the metallurgical industry and in cotton spinning and weaving as well as some sectors of the machinery industry are bound by mandatory plans. In some cases, output above the norms is incorporated into the mandatory planning.²⁴

A second trend is the development of non-commodity relations in goods distribution.²⁵ Commodity rationing coupons exchangeable for specific goods were in use for 102 items in Beijing and 92 items in Shanghai in the sixties. Even in the seventies coupons covered 72 items. After the economic reforms were launched, coupons were gradually phased out so that in the first half of the eighties only grains, edible oils, and cotton cloth remained as coupon-exchangeable goods. But rationing coupons were revived one after another when inflation began in the summer of 1988. Rationing was thus introduced for eggs,

TABLE 4-6
AUTONOMOUS POWERS DELEGATED TO STATE-OWNED ENTERPRISES IN SHANGHAI

	All Powers		Partial Powers		No Powers	
	Number of Replies	%	Number of Replies	%	Number of Replies	%
Planning	67	21.9	198	64.6	41	13.4
Control over production	202	66.2	100	32.8	3	1.0
Personal matters						
Cadre appointment rights	53	17.3	215	70.2	38	12.4
Worker dismissing rights	36	12.3	114	37.7	155	50.8
Financial	37	11.9	239	77.1	34	11.0
Price decisions	34	11.0	151	57.6	77	29.4
Sales	114	44.5	127	49.6	15	5.7

Source: Tao Youzhi et al., "Shanghai quanmin qiye jingyingzhe ze, quan, li diaocha" [An investigation of responsibility, authority and interests of managers in the state-owned enterprises of Shanghai], *Jingji yanjiu*, 1988, No.4, p.69.

Note: Survey questionnaire sent to 322 enterprises.

meat, sugar, bean jelly sticks, toilet paper, soap, detergents, and other daily necessities. Under the adjustment policy in 1989 and 1990, 85–95 per cent of grains, edible oils, eggs, and meat for home consumption were rationed by local governments.

Non-commodity economy is carrying in determining the fringe benefits provided by enterprises and other units. The share taken by house rent in an urban household's living expenses per head was 2.32 per cent in 1957 and 2.61 per cent in 1964. This share slipped to 1.52 per cent in 1983 and further to 0.71 per cent in 1988. This is because rent is frozen in the range of 7.7–7.8 yuan.²⁶ This means that housing subsidies have been increasing. It is reported that public subsidies for housing, food rationing, medical services, and education amount to 80 per cent of the average wages and salaries of staff and workers.²⁷

High-ranking cadres are paid a monthly salary of 250 yuan which is only two times higher than the national average. But such cadres can avail themselves of a personal chauffeured car, telephone, cadre house, special medical services, government-paid maid servants, and specially rationed goods. Such cadres thus receive benefits equivalent to three thousand yuan a year, and their real income is easily four times as high as the national average wage. Leading cadres at or above the vice-bureau director level are said to number only 90,000 nationwide, but those who enjoy this level of privileges are estimated at 210,000 or more.²⁸

Many commodities are rationed within the enterprise and other units exclusively to their constituent members. Of the high grade rice consumed by staff and worker families in Beijing in October–December 1987, 40 per cent came from the units they belonged to in the form of special rationing. They received rice at a price 70 per cent lower than the market price. A survey conducted of

200 households in Shanghai, 70 per cent of them purchased New Year goods from the units they belonged to at a 30 per cent discount. If half of the 100 million urban households throughout the country purchased New Year goods at a price discounted 30 yuan per household, this would be equivalent to their receiving 1.5 billion yuan worth of free foods every year,²⁹ about the same as the value of canned foods sold across the country in 1987. A survey taken in 1988 in Sichuan said that the "concealed wage" per capita not appearing in wage statistics nor on the bank books amounted to 36.46 per cent of the average wage in the province. The concealed wage according to the survey consisted of various cash-paid benefits, provision of benefits in kind, and diverted administrative funds.³⁰

Enterprises distribute to their employees their own products as well as products they purchase from other enterprises. For this purpose large volumes of goods are exchanged between enterprises. For instance, steel products are bartered for passenger cars, gasoline for color TV sets, and chemical fertilizer for grain, fish, and meat. Grain rationing coupons are exchanged for eggs. Those in power can use inside tracks to favor petitioners, and in return they can expect to receive such items as refrigerators or color TV sets. On every festivity day enterprises give special rations. Banquets and outings at public expense have become rampant. Such spending flourished to such a degree that the State Statistical Bureau in its official bulletin in 1988 deplored it saying that "collective consumption at enterprises has increased remarkably."³¹

Fair competition on the market can hardly occur when provision of goods in kind carries an enormous weight and personal favor and corruption are widespread. Hua Sheng et al. in their article analyzed why the lifting of price controls did not lead to the formation of market prices.³² First, they pointed out that most government agencies, using their authority, force enterprises under their control to sell their products at low prices. In some areas, local governments even close the local market to create multiple prices.

Second, they said a situation exists where priorities are given to "small interests of private individuals" rather than to "big interests of large bodies." Individuals and small units belonging to the branches of the State Bureau of Materials and Equipment often sell at low prices in exchange for kickbacks. Bureaucrats having norm allocating powers face temptations to take bribes. For the enterprises on the buying side, whether they can obtain production materials at the official price or only at the market price makes a great cost difference. The norm license thus can serve as an instrument connecting administrative powers to money.

Third, in China the goal of enterprise behavior is not profit maximization but enterprise-welfare maximization. Thus an enterprise can still be considered to be acting rationally even if it sells its products at a lower price, or even for no price, provided that by doing so it can expect to draw benefits for itself and its employees in the form of preferential taxes and financial treatment.

Fourth, the Chinese economy is subject largely to administrative authority and personal connections and not yet fully based on a money economy. Even if one has money, one cannot always expect to be able to buy commodities. In this situation everybody has to depend on the personal favor of, or ties to, those in positions of power.

Fifth, state-owned enterprises still hold monopoly positions. In 1985 the dual government purchase price of grains (state listed prices and higher prices for above-quota purchases) was abolished and replaced by a unified purchase option price. But that eventually turned out to be another official price.

As all these cases illustrate, the weakening of administrative control on the economy at the national government level has not necessarily led to the expansion of autonomous powers at the enterprise level. Nor has the abolition of price controls helped the price factor to perform its expected barometer-like functions. Thus it cannot be said that the price mechanism is functioning normally at China's present stage of reform.

Reform Inconsistencies and Enterprise Behavior

"Honest Men Are Losers"

China's economic reform program at present is at a dead end. The abolition of central government economic control has not generated fair market competition. Instead the structure of the economy has become more complicated and multifarious; contradictions and conflicts have become aggravated. In this socioeconomic environment, Chinese enterprises have developed peculiar adaptive behavior generated by the pattern of economic reform during the past decade.³³

The first characteristic of enterprise behavior is linked to the inconsistencies between the reform measures which have been carried out at the macro and micro levels. While the market-oriented aspect of the reforms was initiated but later stalled, the traditional macro control system has remained intact. At the same time, however, the micro-level enterprise reforms transferring powers to enterprises has continued to be promoted. Consequently two diametrically opposed economic mechanisms have come to exist side by side in a single national economy. On the one hand, enterprises which have been placed outside of government control are completely free, subject to no government control, direct or indirect. On the other hand, those enterprises which have remained under the old system are still unable to act on their own discretion.

The second feature determining enterprise behavior has been that the transfer of power to enterprises has not been in conjunction with them taking responsibilities and risks for their action. For this reason enterprises have generally taken the attitude that they will follow the reforms if and only if these bring explicit and direct benefits to them. Otherwise they will not accept reform.

The third feature is that reforms which promised direct benefits to the enterprises could not be applied simultaneously all over the country, but had to be confined to specific areas and industries, such as special economic zones, coastal open cities, *jihua danlie chengshi* (cities given the power to plan independently of their provinces), and industries that introduced the contract management responsibility systems. The areas and industries singled out for preferential treatment have become special areas where macro control practically does not function. Taking advantage of such disjunctive systems, shrewd enterprises and individuals play their games. This is a circumstance in which honest people lose. The "dishonest" use this opportunity to promote their self-interests committing all kinds of irregularities, and this phenomena is spreading.

The geographically uneven preferential treatment generates regional disparities. The regions not favored become discontented. Raw materials produced in inland regions where prices are kept low naturally flow to coastal areas where the prices for the same products are high. The inland regions thus suffer from shortages of materials and the local governments have had to close their borders. What is called *zhuhou jingji* (parochialism) appears in some provinces and regions where the local governments and local industries are united in pursuit of their exclusive interests.³⁴

The fourth feature is that administrative powers are commodified. As the commodity economy expanded, the government agencies and bureaucrats monopolizing material allocation rights and business licensing powers have developed the art of translating their powers into business transactions and maximizing their particular economic interests. In the absence of market mechanisms, bribery, nepotism, and personal favor are the only means of influencing the economic processes. Bureaucrat brokers (*guandao*) have taken over, and paper companies established by the government agencies and the party organizations have become fashionable. Shops and other commercial units increased from 1,260,000 in 1978 to 12,670,000 in 1988. The number of *gongsi* (companies partially characterized as government agencies) grew from 270,000 in 1985 to 477,000 in 1988, 39 per cent of them established in the second half of 1986.³⁵

The inconsistency in the reform program and the delay in the formation of institutionalized markets have created major pockets in the economy where no control is practiced. These pockets have created opportunities of windfall profits. Official and private bodies are frantically running after such profits. This situation has resulted from contradictions arising from the reforms. Table 4-7 provides an extensive list of the forms of corruption by individuals, party organizations, administrative offices, and enterprises, in the areas of organizational management, law enforcement, production, and distribution.

The Struggle over Quasi Rent

How are the "pockets" created by the reforms explained in economic terms? The pocket is most graphically explained by the emergence of "quasi rent" due to the dual pricing system.

Quasi rent is usually defined as the producer's surplus generated by the difference in advantages enjoyed by enterprises. Figure 4-2 provides an explanation. SS' is an industry's supply curve and DD' is its demand curve. OH is the output under conditions of supply-demand equilibrium. Within an industry are enterprises having relatively good advantages and others having no advantages to speak of. In the figure, the enterprises in a specific industry are arranged on line OH in accordance with the degree of advantage enjoyed in production cost and output. Advantage decreases as you go from the most advantaged enterprise in the left to the least advantaged enterprise in the right. In a complete market economy, P_1 shows the equilibrium price per unit of output. The OH th enterprise on the line have no relative advantage, but the OM th enterprise have. In this case, QM minus RM , namely, QR , is the quasi rent that the OM th enterprises obtain.

Now let us examine a completely controlled economy. There, the total output, that is OH , is sold at the official price P_0 . In this case, the total quasi rent, P_0SR , is recovered by the state and then used to compensate less advantaged enterprises for their losses, namely, ARK .

Under the dual pricing system where the market and official prices coexist, there is the possibility of goods which are supposed to be sold at the official price being sold at the market equilibrium price P_1 . Therefore, for the enterprises between O and M , P_1P_0RQ , which is the differential between the market price P_1 and official price P_0 , emerges as quasi rent. Also, QRA , the differential between the sales price and production cost, is another portion of quasi rent. Thus fierce struggles occur to win the lion's share quasi rent, P_0RAQP_1 . In this struggle enterprises do all they can to sell products through illegal channels and buy goods for resale. Meanwhile government agencies and their bureaucrats try to make fortunes using their power to issue goods distribution permits.

How large are quasi rents? Hu Heli calculated the amount of quasi rents arising from the dual pricing system using the following formula:³⁶

$$R = \sum_{i=1}^n (P_{fi} - P_{oi})Q_i,$$

where R = quasi rent, P_{fi} = market price of i th item, P_{oi} = official price of i th item, and Q_i = volume of extra-plan sales of i th item.

According to his calculations, quasi rents totaled 356.9 billion yuan. He broke this down into 150 billion for the differential between the official and market prices of government-controlled commodities, 113.88 billion yuan for the differential between the official and market interest rates, and 93.04 billion yuan for the differential between the exchange rate applied to imports and the market exchange rate.³⁷ The quasi rent total was equal to 25.5 per cent of China's GNP in 1988. If the nation's high ranking bureaucrats skimmed off 5 per cent of the total, they may have easily pocketed 17.8 billion yuan. If so, they would have embezzled far more money than the total wages and salaries of 8.17 mil-

TABLE
TYPES O

	Personal Corruption		Corruption in Lower and Part
	For Protection	Not for Protection	Through Relatives
Management	Patriarchal domination corruption, and bribing (to protect relatives and acquaintances)	Bribing and other irregularities (on behalf of employee collectives or in economic action)	Nepotism and other underhanded dealings (through relatives)
Law	Protecting relatives or acquaintances having committed economic crimes	Speculation and other economic crimes	Securing licensing rights and favorable distribution shares for the sake of relatives
Production	Setting up sub-contract enterprises to profit relatives and acquaintances	Contracting with specific selling enterprises on preferential conditions	Provision of modern equipment for relatives
Distribution	Special favors for relatives and acquaintances	Bribes and gifts to obtain preferential treatment	Provisions of preferential treatment in housing for relatives

Source: Li Nanxiong, "Guanyu Zhongguo fubai xianxiang de yanjiu," *Jingji-shehui-tizhi-bijiao Zhongguo-zhangwang-chubanshe*, 1989), p.13.

lion public servants in government service and party functionaries which totaled 13.6 billion yuan in 1988.

Distorted Enterprise Behavior

Given the above-mentioned immaturity of the market mechanism, lack of consistency between reform measures, and resultant presence of pockets, the behavior of Chinese enterprises at the present reform stage still deviates from that of an "orthodox enterprise." By "orthodox enterprise" is meant an enterprise which, in its pursuit to maximize profits, actively promotes research and development, makes investments, extends marketing, and procure financing, thus endeavoring to increase productivity and achieve technological progress and finally to accumulate a significant volume of profits for its further growth and development.³⁸

In the Chinese economic reform program, priorities were given to the decentralization of power to enterprises. This was intended to create orthodox enter-

4-7

CORRUPTION

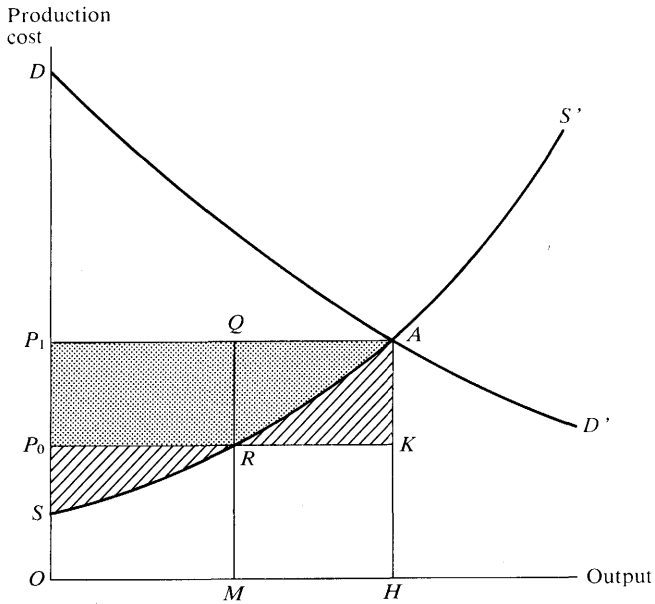
Echelon Administrative Organizations	Corruption in Enterprises	
	Not Through Relatives	Making Use of Personal Ties
Gifts and excess favor for certain persons	Nepotistic hiring	Conceding position to subordinates prior to retirement
Bribing and other intervention to evade law enforcement	Crimes in commercial transactions committed by employees on the strength of the prestige of their enterprises	Tax evasion and illegal retention of profits
Intervention and bribing to obtain preferential treatment	Special subsidies provided by personnel to factories and workshops controlled by their subordinates	Obtaining permission for production outside of planning and other privileges
Mutual assistance to obtain material benefits	Bonus payments in kind, collective consumption at the workshop level, extravagant gifts, preferential treatment in fringe benefits and housing allocation	"Unit chauvinism" (<i>danwei zhuyi</i>) whereby provision of subsidies, allowances, and houses is made limitlessly

bianjibu ed., *Fubai: huobi yu quanli de jiaohuan* [Corruption: exchange between money and power] (Beijing:

prises. In the area of laws and regulations, Chinese enterprises have acquired greater autonomy over production, research and development, marketing, employment, wages, internal reserves, equipment expansion, and merger with other enterprises. Even so, more than ten years after the reforms were launched, the corporate behavior of the vast majority of Chinese enterprises remains far different from that of orthodox enterprises. They do not fully exercise legally recognized powers regarding research and development, technological innovation, and the expansion of internal reserves. Rather than winning new customers through active marketing, they seek to profiteer by dint of the differential between the official and market prices. Instead of increasing internal reserves, they prefer to appropriate profits for bonuses and fringe benefits to their employees.³⁹

A survey conducted of 149 state manufacturing enterprises in Harbin City revealed the uses of retained profits as shown in Table 4-8. There is a regulation that the share of the production development fund should be 50 per cent

Fig. 4-2. Quasi Rent under the Dual Pricing System



or more of the total retained profits, but this regulation is not honored. Enterprise welfare costs are above 50 per cent in all cases.⁴⁰

Organizationally the enterprise has been revamped as a body operating to maximize profits. But the actual behavior of the now largely autonomous enterprise has not fulfilled the expectations of the reforms. Case studies on distorted enterprise behavior have been conducted by the Institute of Economics of the Chinese Academy of Social Sciences. The studies covered forty state-owned enterprises located in cities and counties in Wuhan, Changsha, Zhenjiang, and Lin'an.⁴¹ According to the studies, the behavior of these enterprises deviates from that originally expected to arise from the economic reform program in that they pursue their individual self-interests in the procurement of funds, product marketing, inventory formation, and decision making. Below are examples of enterprise behavior taken from the institute's case studies.

Fund procurement

Inflation spiraled in 1988. The price of zinc, the mainstay raw material of the Zhenjiang City storage battery factory, soared 2.6 times on the open market between January and September of that year. But the amount of zinc procurable under the economic plan, which accounted for 43 per cent of the total zinc consumed at the factory in 1987, was reduced to only 20 per cent

TABLE 4-8
USES OF RETAINED PROFITS (HARBIN MUNICIPAL DISTRICT; 149 ENTERPRISES, 1988)

	Total (1,000 Yuan)	Share in Retained Profits (%)			
		Average	Large Enterprises	Medium-size Enterprises	Small Enterprises
Production development fund	56,056.7	34.0	34.5	37.6	25.0
Bonus fund	10,581.2	6.5	9.6	1.2	6.2
Welfare fund	98,112.1	59.5	55.9	61.2	68.8

Source: Liu Renxiu and Zou Bailin, "Qiye duanqi xingwei chuyi" [A humble study on the shortsighted behavior of enterprises], *Jingji guanli*, 1990, No.3, P.26.

in 1988, only half of which was actually allocated. Finding funds to buy the raw material became a life-or-death matter for this enterprise.

In this context, the Chinese enterprise's capacity to pay for raw materials depends on its ability to obtain bank loans. An enterprise at Wuhan City, having fixed assets worth only 500,000 yuan, was able to draw a 25 million yuan bank loan because its director had strong personal connections with bank officials.

Product marketing

Commodities in short supply are now a more powerful means of exchange than money. Because of this, local governments are anxious to keep scarce and precious local commodities under their direct control in order to utilizing their exchange value for the benefit of the local economy and specific individuals. By accepting such control, enterprises have to deliver their products at low prices, but they are compensated by preferential treatment in the forms of low or no taxes, better access to loans, easy permission to investment, and higher ceilings for bonus funds. To receive the title of "excellent entrepreneurship" also benefits enterprise managers. These all serve as incentives for the enterprise. A steel mill at Hunan Province thus is delivering 95 per cent of its products to the government at low official prices, which are one tenth of the market prices.

Inventory formation

Wuhan radio and telecommunication equipment factory usually needs a two-month inventory of plastics for video tape-recorders. But a survey made in September 1988 showed that the factory had a plastics inventory that would keep it running for one year.

There is also a tendency for enterprises to stock raw materials which are irrelevant in kind, standard, and quality, to their actual production. They keep such materials in the hope that they can exchange them for materials they need for production. In other cases, large stocks of unrelated goods are held just

for resale and profiteering. An enterprise in Lin'an County bought ten thousand tons of coal and resold it three months later. This brought it a profit of one million yuan.

As bonuses are often paid in kind, a factory's inventory includes daily necessities for this purpose. There is even an enterprise which built a refrigerated warehouse simply to stock chickens for distribution to employees on festival days.

Price determination

Fifty-six enterprises in Zhenjiang City were forced to spend 42 million yuan extra following raw material price hikes between January and June 1988. These enterprises increased their revenues by 48 million yuan by raising the prices of their products. Their cost increases were thus 114.3 per cent shifted onto their product prices. Few enterprises strive to absorb raw material cost increases by rationalization and other means of cost reduction.

These examples of distorted enterprise behavior resulting from insufficient operation of the market mechanism characterizes not only state-owned enterprises but also township- and village-run enterprises (*xiangzhen qiye*). They pursue temporary interests by utilizing connections with local government officials, or even by selling fake drugs, fake wines, and the like. In coastal cities like Wenzhou, local self-employed merchants and private enterprise owners openly exchange bundles of small banknotes valued at 103, 104, or even 105 yuan, for a single 100 yuan note, taking advantage of the fact that a larger note is more convenient for carrying to distant places and for bribing. Cash transactions make sense for tax evasion as well as for the blackmarketeering of scarce commodities.⁴²

Medium- and Long-term Perspectives of Economic Reform

Marketization of Economy Progressed Even under Adjustment Policy

The Chinese economic reform is now caught on the horns of a dilemma. Should decentralization and marketization be promoted, inflation will be the consequence. Should state control on economy strengthened, the old system will survive and state-owned enterprises will remain stagnant. It is not easy to resolve this dilemma. The only way would be to go slow and steady in full recognition that full marketization is a long-term task.

China followed this path. China's unceasing efforts to carry out price reform and its successes in establishing a variety of markets even under the adjustment policy should be acclaimed from this standpoint.

China started large-scale price adjustment from about the end of 1989, involving a broad range of goods and services—sugar crops, oil-bean crops, and other agricultural products as well as oil, steel, coal, and railway cargo rates. Retail prices of daily necessities and public service charges such as electricity,

gas, and water charges, bus fares, and public park admission fees were all drastically raised.

As was pointed out in Chapter 3, the weight government-determined prices carry has been declining. Now, even the government-determined prices are not fixed on the government decision. Of the coal under the unified distribution by the central government, only 36.5 per cent of sales sum is sold at the government-fixed price. The central government unitarily distributed only 37.5 per cent of the steel produced in 1989. Of that portion, 71 per cent was sold at the government-fixed price and remaining 29 per cent at premium prices. This meant that only less than one third of the year's steel output was sold at the government-fixed price.⁴³

Creating market systems requires not merely abolition of control on prices, production, and distribution, but also the establishment of markets as the arena where the market mechanism functions. The various markets whose opening had been prepared at the 1988 height of reform and open-door upheaval were inaugurated one after another during the adjustment period.

Thus, the number of consumer retail shops has become eight times and the number of free markets in rural and urban areas twice as many as they were, respectively, at the end of the 1970s. Producer- and capital-goods markets were set up for steel, nonferrous metals, electrical machinery, timber, construction materials, chemical materials, light industry materials, cars, coal, and oil.

In financial areas, securities business developed in Shenyang, Shanghai, Taiyuan, Chongqing, Wuhan, Xiamen, Shenzhen, Guanzhou, and Fuzhou, and on this basis, stock exchanges were opened in Shanghai and Shenzhen. In addition, call rate transactions, bill discounting transactions, insurance business, and foreign exchange market are expected to be further activated.

In rural areas, private financial interests such as *yaohui*, usurers, and investment and trust corporations organized by township offices cropped up, in addition to the Agricultural Bank and Credit Cooperatives which had been already in existence.⁴⁴

In Zhengzhou, Henan Province, a national wholesale market for grain was opened in October 1990 where futures transactions were introduced. Provincial wholesale markets for grain have also been inaugurated at Jiujiang, Wuhu, Wuhan, Changchun, Harbing, and Changsha.

In the meantime, contract workers came to account for 13.3 per cent of the total state-owned enterprise employees at the end of 1990. Vast numbers of rural population began to flow into cities in seeking jobs. They are estimated to have reached 50 million or 80 million.⁴⁵

Foreign investment has remained active even under the adjustment policy, its annual increase rate renewing record every year since 1990. Also conspicuous is the development of the South China Economies comprising Guangdong and Fujian provinces based on close economic relations with Hong Kong and Taiwan.

Considering what has happened in the areas of price reform, inauguration of markets, and external economic exchange, China has not retreated into the past. As shown in Table 4-1 at the beginning of this chapter, not only reformist scholars but top leaders such as Jiang Zemin proposed the establishment of the "socialist market economy" in summer of 1992. This proposal explicitly surpassed the dimension of the "planned commodity economy." Chinese economic reform has entered the fourth stage. It is therefore important to examine here what market economy model China envisages in the future.

Outline of Medium- and Long-term Planning

I pointed out that the Zhao Ziyang report at the 14th National Congress of the Communist Party of China in the autumn of 1987 made an epoch in China's history of economic reform. Referring to how economy should be managed, Zhao proposed this formulation: "the state to regulate the market and the market to guide enterprises."

Liao Jili, vice-chairman of the China Economic System Reform Society, said that under this system of economic management, consumption goods, producer-goods, services, finances, and labor forces were all to be channeled through market transactions and that the government would exercise macro control mainly through its fiscal and financial policies.⁴⁶

A conceptual model of reform has thus been already proposed, but the Chinese government has not yet shown us how this is to be evolved into systematic practice. To do so, a medium- and long-term reform design would be required. In the autumn of 1987, the State Commission for Restructuring the Economic System contracted out research projects on three-, five-, and eight-year term reforms to nine research institutes and universities. The institutes picked for the research and their representatives are as follows:

- (a) The research project team for the middle-term reform at the Institute of China Economic System Reform (Cheng Xiaonong, Song Guoqing, and others)
- (b) The Wu Jinglian project team at the State Council's Economic, Technical, and Social Development Research Center (Wu Jinglian and Zhou Xiaoquan)
- (c) The State Planning Commission project team (Liu Hong and Hong Jiahe)
- (d) The project team on a middle-term program on economic system reform at the Chinese Academy of Social Sciences (Liu Guoguang and Zhang Zhuoyuan)
- (e) The three-, five-, and eight-years' reform plan project team at Beijing University (Li Yining)
- (f) The research group for economic system reform of the research team of the Central Party School of CPC (Wang Jue)
- (g) The People's University of China project team (Wu Shuqing)
- (h) A project team at the Development Institute of China's Rural Development Research Center (vice-director Chen Xiwen)
- (i) A Shanghai System Reform Committee project team (chairman He Gaosheng)

The proposal produced by the Beijing University group suggests seven items of reform for the three phases of reform, namely, 1989–90, 1991–92, and 1993–95, as Table 4-9 shows. This proposal presented as the final reform goals the full adoption of the joint stock enterprise system, complete abolition of price control and evolution for mature financial and labor markets. Reform proposals from other institutes are by and large the same on the main items as the Beijing University design.⁴⁷

It is true that China had to shift to adjustment policies. At the sight of the repression of the democratization movement at Tian-anmen Western sources were afraid that the reform and open-door line might be canceled. But we should remember that the designs from all of the said nine institutes had upheld basically the same reform goals. These institutes in fact are China's representative brain-truster groups. And they still hold influence on China's policy making. It is therefore predicted that despite short-term policy changes that may occur with possible changes in top-leadership, China's basic reform and open-door line will be maintained.

However, the proposed basic design is still a mere design. To come to grips with the realities, it should be mediated by more concrete and detailed policies, measures or methods. Though all the said groups agree on the goals, they differ when they come to the point of where to begin. For instance, Wu Jinglian of the State Council's Development Research Center emphasizes the importance of price reform⁴⁸ while Prof. Li Yining at Beijing University holds that the first priority should be given to ownership system reforms, arguing that the reform would inevitably fail if price reform should come first.⁴⁹ Liu Guoguang, vice-president of the Chinese Academy of Social Sciences, and Zhang Zhuoyuan, the director of the Institute of Financial Material Economy, insist that reforms should be promoted in parallel in all the areas.⁵⁰ Whatever their emphasis and priorities, however, they all lack concrete plans for implementation.

The price control for meat, vegetables, and fruit was experimentally abolished in 1985 and 1988, but on both occasions, little attention was paid to the improvement of circumstantial conditions such as distribution organizations or traffic systems relevant to these price reforms. It does not seem that serious studies were made on possible reaction of the masses to price changes as well as on social unrest that may arise in the wake of abolition of price control. Nor were there studies, to the best of my knowledge, on measures to be taken vis-à-vis such social unrest.⁵¹ Moreover the top Chinese leaders lacked the will and the unity to conquer difficulties and accomplish the price reform.⁵² The Chinese government should not have so easily retracted a policy which had the unanimous agreement of the entire government and bureaucratic apparatus.⁵³

The Three-stage Reform Program by the State Commission for Restructuring the Economic System

In the summer of 1991, the State Commission for Restructuring the Economic System disclosed its Ten Years' Program Concerning Economic System Reform

TABLE 4-9
REFORM PROPOSALS BY BEIJING UNIVERSITY

	1988-90	1991-92	1993-95
(1) Enterprise reform	<p>(1) Contract system strengthened; all personnel to bear risks</p> <p>(2) Normalization of order forms</p> <p>(3) Experiment with joint stock system</p> <p>(4) Promoting enterprise mergers</p>	<p>(1) Transition from contract system to joint-stock system</p> <p>(2) Establishment of government assets-management organizations</p> <p>(3) Experiment with joint stock system</p>	<p>(1) Transforming large and medium-sized enterprises in general industries into joint-stock companies</p> <p>(2) Promoting holding companies; developing enterprise groups</p>
(2) Agricultural reform	<p>(1) Establishing a fund for standardization of agricultural products</p> <p>(2) Organizing cooperatives for transportation and marketing of agricultural products</p> <p>(3) Developing cultivating and harvesting agencies on behalf of peasants</p>	<p>(1) Establishing land banks and credit associations for land lease brokerage</p> <p>(2) Aligning cooperatives for transportation and marketing of agricultural products</p>	<p>(1) Fostering large household farms specializing in certain products</p> <p>(2) Encouraging household farms to voluntarily organize "agricultural, industrial, commercial, transportation, and construction combines,"</p>
(3) Financial reform	<p>(1) Changing state-owned specialized banks from institutions to enterprises</p> <p>(2) Creating a dual-credit system (planned loans and market loans)</p>	<p>(1) Turning some specialized banks into joint-stock companies</p> <p>(2) Establishing a first and second section for stock exchange</p>	<p>(1) Establishing industrial and financial combinations</p> <p>(2) Liberalizing interests with government's indirect control</p>
(4) Trade reform	<p>(1) Contract system for trading enterprises</p> <p>(2) Increasing the rate of foreign exchange retention</p>	<p>(1) Turning trading enterprises into joint-stock companies</p> <p>(2) Giving large and medium-sized enterprises the power to conduct foreign trade</p> <p>(3) Further increasing the foreign exchange retention rate</p>	<p>(1) Currency floating under administrative control</p> <p>(2) Independent accounting for trading enterprises</p>
(5) Fiscal reform	<p>Contract system to be responsible for fiscal revenues and expenditures (fixed-amount and progressive contracts for turning over revenues)</p>	<p>Adjusting tax composition; Preparing for "fenshuizhi" (separate tax systems)^a for the central and local governments</p>	<p>Cutting the irregular ties between local governments and enterprises by applying the separate tax system</p>

TABLE 4-9 (Continued)

	1988-90	1991-92	1993-95
(6) Price reform	(1) Securing basic price stability (2) Partial revision in prices	Revising prices for a relatively large number of items; preparation for abolishing price controls	(1) Full functioning of market prices; government controlling prices through indirect measures (2) Maintaining competition by enforcing anti-monopoly legislation; protection of consumers
(7) Wage reform	(1) Contracting for a certain quota of the total wage bill between the government and an enterprise (2) Increasing wages and salaries for public servants in proportion to price increase	(1) Standardizing enterprise wage system; wages linked with enterprise profitability (2) Adjusting individual income disparities by means of individual income taxes	(1) Wages decided on the labor market on the premise that transfer of labor is liberalized (2) Preferential wages for public servants, linked with the consumer price index

Source: *Shijie jingji daobao*, May 23, 1988.

^a A system under which the kind of taxes collected by the central and local governments are specified so as to draw a clear line of demarcation between central and local finances.

mapping out reforms to be carried out before the year 2000. According to the program, the reform will be three-staged.⁵⁴

The first stage, 1991–92, still strongly retains adjustment aspects, with emphasis on stable economic growth and enhancement of economic efficiency.

Central to this stage are measures to activate large and medium-sized state-owned enterprises which suffer from deteriorating business performance. As a means to achieve this goal, the contract management responsibility system should be improved and formation of enterprise groups encouraged. Also promoted are reforms in the price system, housing system, and social insurance system. In the meantime, markets for producer-goods, financial, technology, real assets and labor will be fostered while the government's macro control on them will be reinforced.

On the second stage, 1993–95, where the scope of reform will be expanded, major reform steps will be taken.

First, "*shuili fenliu*," or the separation of tax from profit, will be spread far and wide. Under the existing corporate tax system, large and medium-sized enterprises pay 55 per cent of their profits in tax while small enterprises are subject to eight-scale progressive taxation. Under the newly proposed formula, the corporate taxes will be changed to a uniform 35 per cent for enterprises of all sizes. With this change, the enterprises will no longer be permitted to subtract depreciation cost of fixed capital or funds for bonuses and fringe benefits for their employees from their pre-tax revenues.

Second, "*fenshuizhi*," or a separate tax system, will be introduced. This means that the kinds of taxes collected by the central and local governments will be respectively defined. This system is intended to draw a sharp line between the central and local finance and increase the central government's share in proportion to an increase of the total amount of collected taxes.⁵⁵

Third, more and more state-owned enterprises will be turned into joint stock systems, based mainly on mutual sharing of stocks among state-owned enterprises.

Fourth, full-scale reform and open-door program will be experimentally implemented in the three provinces of Guangdong, Fujian, and Hainan.

The third stage is set for 1996–2000. The goal here is to complete a new economic management system based on organic combination of planned economy and market economy. In this period, China will about complete its transition from the old to the new system.

The final goals of the reform are the following four: first, the establishment of a unified market economic system under the government control; second, remaking the ownership structure into a fully rational structure and further activating state-owned enterprises; third, full liberalization of prices; fourth, coordination of possible various conflicts of interests (e.g., conflicts over distribution between the central and local governments, regional disparities, etc.); and fifth, improvement in, and standardization of, housing, post-retirement, and medical insurance systems.

TABLE 4-10
COMPARATIVE SYSTEM MODELS

Basic Models	Sub-models	Forms of Ownership and Management	Forms of Co-ordinating between Economic Subjects	Forms of Co-ordinating between Governments and Enterprises	Cases of Typical of Each Model
Free capitalism	(1) Free capitalism	Privately owned, privately run	Market	Laissez-faire	The principle world of the neo-classical school
Regulated capitalism	(2) Regulated capitalism ^a	Privately owned, privately run	Market	Regulation (indirect control)	Japan today
Controlled capitalism	(3) Partially controlled capitalism	Privately owned, privately run	Market	Mandate	Japan in the first half of the 1950s
	(4) Completely controlled capitalism	Privately owned, state-run	Central control	Mandate	Wartime Japan
Mandatory socialism	(5) Completely mandatory socialism	State-owned, state-run	Central control	Mandate	China before 1978 and the former Soviet Union
Guided socialism	(6) Guided socialism	State-owned, state-run	Market	Guidance (indirect control)	Hungary 1960-80 and China today
	(2) Guided socialism	State-owned, privately run	Market	Guidance (indirect control)	China in the future
Self-management socialism	(8) Self-management socialism	Socially owned, self-managed	Market + co-operation	Guidance + co-operation	Former Yugoslavia

Source: Based on Ritschi Tabata, *Hikaku keizai kenkyū* [Comparative economics] (Tokyo: Kōyō-shobō, 1990), p.20; the column "cases typical of each model" has been added by the author.

^a Tabata uses the term "guided capitalism" (*yūdō shihonshugi*) but this author prefers "regulated capitalism" (*kisei shihonshugi*).

The Future Model China Makes for

If the economic reform is carried out as designed out by the State Commission for Restructuring the Economic System, China will accomplish the conversion to a almost complete market economy in the twenty-first century. As far as the institutional framework is concerned, China then will have a market economic system mostly identical with the Western system except in one crucial point. That point is that in the Chinese case, the state-owned assets management bureau will still be holding one third to half of the stock shares of the state-owned enterprises, which will remain as major economic powers in the Chinese economy. With this characteristic Chinese socialism will be demarcated from the Western conventional market economies. Table 4-10 made by Professor Riichi Tabata idealizes various economic models encompassing socialism and capitalism and shows countries roughly falling into those model categories. It can be said in reference to this table that the model the state commission prefers is a guided socialist model with state-owned and privately run enterprises.

To date, the Chinese state-owned enterprises and state-run enterprises have been almost synonymous.⁵⁶ Now we know that China favors the guided socialist model with state-owned and privately run enterprises. But how that model is attained and how the system of this model is run is not yet clear enough. A number of points should still be clarified more concretely, such as what kind of individuals or organizations will manage the state-owned enterprises after privatization of state assets, how stock transactions will be done, and how the stockholders will exercise their rights.⁵⁷

Figure 4-3 shows a system of state asset management as designed by Zhang Jixiang, Director of the state-owned assets management bureau which was established under the Ministry of Finance in 1988.⁵⁸ Zhang's system has four characteristic aspects.

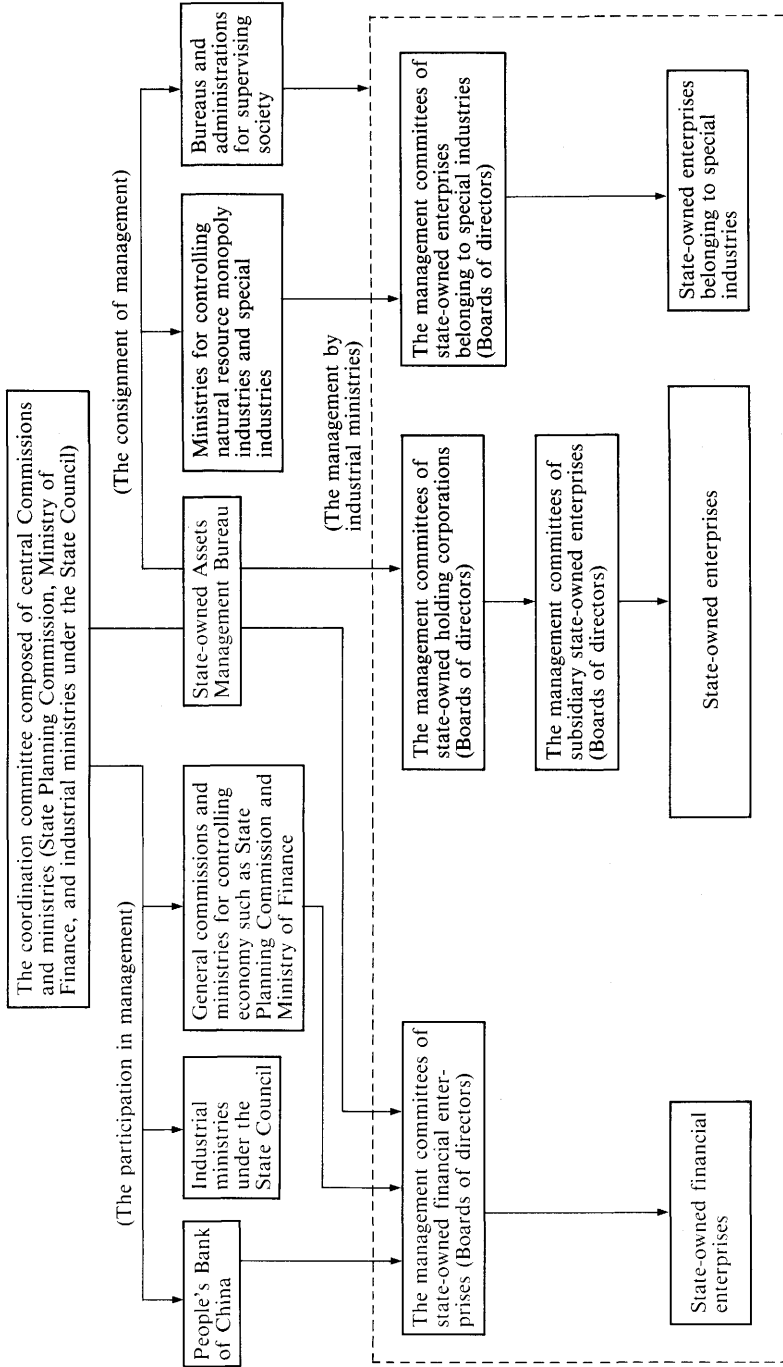
First, a committee is to be set up for coordination of views and interests among different central government ministries. The coordination committee is to consist of the Planning Commission, Ministry of Finance, the industrial ministries and other related ministries under the State Council.

Second, the state-owned assets are managed in the following three different ways.

(1) Concerning those industries which have the tendency of monopolizing natural resources and technologies and also have a highly public or specific character, the state-owned enterprises therein are placed under the strict control of the government agencies in charge of them. For instance, government offices designated by the state-owned assets management bureau shall manage matters pertaining to the dispatch of government representatives to the enterprise management committees (board of directors), appointment of main directors, and ratification of business plans of enterprises.

(2) Banks and other state-owned financial enterprises are supervised by

Fig. 4-3. A Design of State-owned Assets Management System



Sources: Zhang Jixiang, "Lun jianli woguo xinxing de shehuizhuyi guoyou zichan guanli tizhi" [Establishing the new system for socialist state-owned assets management in our country], *Zhongguo gongye jingji yanjiu*, 1991, No.2, p.30

representatives dispatched to their management committees from the state-owned assets management bureau and the People's Bank of China. Their business plans are placed under the control of the People's Bank of China.

(3) As for general state-owned enterprises other than those in the above two categories, they are encouraged to form enterprises groups subject to multi-layered management. The state-owned assets management bureau exercises management powers over mainly the large and medium-sized key state-owned enterprises in the capacity of their owner. The bureau manages general medium and small state-owned enterprises indirectly through various holding company management committees. Generally, the performance of these state-owned enterprises are evaluated through their profit targets. The mandatory plans and contracts given to these enterprises by the government shall not prejudice their profit positions.

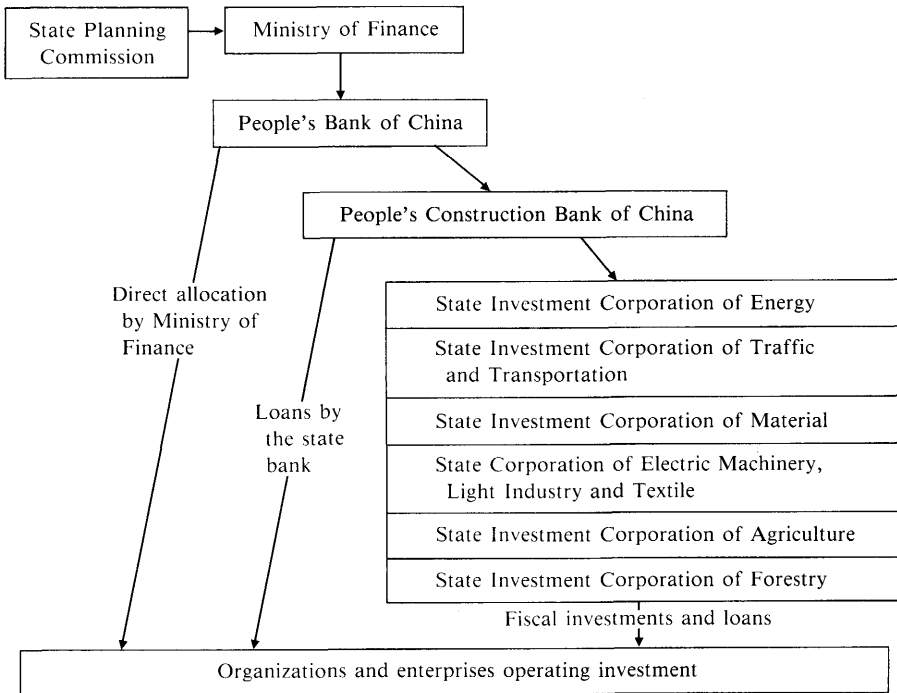
Third, a state investment corporation will be set up encompassing various industries to manage funds for new investment forming state-owned assets.

There are three routes for managing China's fixed assets investment. As is clear from Figure 4-4, new capital construction investment (*jiben jianshe touzi*) used to be provided in the form of grant directly from the state finance according to the state plans (route 1). The State Planning Commission was directly controlling on the choice of projects, the decision of enterprises in charge, approving construction plans, and allocating quotas. In 1979 the formula of free provision of investment fund began to be modified in favor of interest-bearing bank loans (route 2). In 1988, a special budget for capital construction was created on an experimental basis (route 3). This last is the most important future route through which the state investment corporation induce investment of state-owned enterprises. But investment through this channel still has but a meager share in the total of investment in China. This system resembles the Japanese government loan and investment program under which savings are funneled into the private sector through public enterprises such as the Development Bank and the Housing Financial Corporation.

Fourth, the state-owned assets management bureau will create a series of reporting and information systems with proper organizational structures. Thus, the bureau will heighten its management functions with the collaboration of the Statistical Bureau, Supervisory Bureau, Administration for Industry and Commerce, Price Bureau, and the Auditing Administration.

By the way, it should not be forgotten that the above are just all medium- and long-term perspectives as proposed by Chinese administrative offices and research institutes. History has not yet known any cases that a system under which national economy was dominated by state-owned and privately run enterprises successfully functioned. Once in 1950s Chinese government had established the "joint state-private enterprises" to control the national bourgeoisie capital, but this joint state-private type was only the transitional step to nationalization.

Fig. 4-4. Circulation Routes for Capital Construction Funds from the State Budget



Source: By the author.

If things go wrong, the system of “state-owned and privately run” may let the “bureaucrat capital” dominate the major part of national economy as seen in the period of the Republic of China. Taking this historical experience into consideration, there is of course no guarantee that the Chinese experiment with this model will be successful.

Although there is an agreement in China on peaceful and gradual reform at the present stage, it is possible that radical liberals may attempt to overthrow the present regime. The possibility that national independent movement may flare up has not been eliminated. Plans for gradual reform from above can easily be overthrown should such political events occur.

Summary

The market economy has its own principles that need to be followed and an order that needs to be respected. Just removing controls and liberalizing everything does not create a market economy. How to build and control a market

economy is still a difficult task facing China today. It will be a long time before China can institutionalize new economic reform measures and get them to work normally. Until such a time, the distribution in enterprises behavior will not be corrected.

Since early 1992 China has rushed into a new stage of accelerated economic reform and open-door policy. The open-door policy has been extended to inland cities from the coastal districts. Several new provisions and measures have been promulgated to remodel the management mechanism of state-owned enterprises and even to adopt joint-stock systems. However, there has been no fundamental change in the basic conditions which has made China's economic reforms fall into difficulties. Considering the social chaos that could arise, China has to proceed prudently and circumspectly in its economic reforms, trying in this process to mitigate the various contradictions and obstacles.

Notes

This chapter is based on the author's "Chūgoku keizai kaikaku no kiseki to mujun" [The trajectory and contradictions of China's economic reform] in *Kaikaku-kaihō jidai no Chūgoku* [China in the era of reform and the open-door], ed. Tatsumi Okabe and Kazuko Mōri (Tokyo: Japan Institute of International Affairs, 1991) and "Economic Reform and the Behavior of State Enterprises in China," *Developing Economies*, Vo.28, No.4 (December 1990).

1 *Renmin ribao*, October 26, 1987.

2 Dong Fureng, "Jingji yunxing jizhi de gaige he suoyouzhi de gaige" [Reform of the economic operative mechanisms and of ownership], *Jingji yanjiu*, 1988, No.7, pp.27-33.

3 *Renmin ribao*, August 16, 1989.

4 *Remin ribao*, April 12, 1991.

5 Xun Dazhi, "Inflation and implementation of China's Economic Adjustment Policy," in *Chinese Economy under the Adjustment Policy*, ed. K. Ishihara, Joint Research Program Series No.91 (Tokyo: Institute of Developing Economies, 1991), pp.42-45.

6 Zhongguo-jingji-nianjian-bianji-wei-yuanhui, ed., *Zhongguo jingji nianjian, 1989* [Economic yearbook of China, 1989] (Beijing: Jingji-guanli-chubanshe, 1989), pp.III-4-6; Dong Dalin. "Zhongguo jingji tizhi gaige shinian jianshu" [Brief description of Chinese economic system reform during the past decade], *China's Economic Structure Reform*, 1989, No.2, p.12.

7 According to *Zhongguo jingji nianjian, 1989*, p.IV-47, extraplan employment in 1988 totaled 10,418,000 jobs; beyond this figure, however, there are a lot of other temporary workers (Yang Yongzhong, "Zai zhili zhengdun zhong wangshan laowu shichang" [Improving the labor market by carrying out the austerity programme], *Zhongguo jingji tizhi gaige*, 1989, No.12, p.22).

8 Estimated by the author from *Zhongguo laodong gongzi tongji ziliao* [Statistical data on labor and wages in China] (Beijing: Zhongguo-tongji-chubanshe, 1989), p.67.

- 9 Guo Zhishan, "Shinian gaige qijian gongye qiye jingji xiaoyi zongheng" [An overall look at the industrial economic results during the ten-year reform], *Zhongguo jingji tizhi gaige*, 1990, No.5, p.10.
- 10 Ibid., p.11. The wage-profit ratio (profit including paid taxes) as corroborated by this author was 24.2 per cent for 1978 (in 1970 prices), 13.4 per cent for 1982 (1980 prices), 20.3 per cent for 1987 (1980 prices), and 20.5 per cent for 1988 (1988 prices). See State Statistical Bureau, ed., *Zhongguo gongye jingji tongji nianjian, 1988* [Industrial economic statistical yearbook of China, 1988] (Beijing: Zhongguo-tongji-chubanshe, 1988), p.49 and idem, *Zhongguo tongji nianjian, 1989* [Statistical yearbook of China, 1989] (Beijing: Zhongguo-tongji-chubanshe, 1989), p.333.
- 11 See Chapter 3.
- 12 Guowuyuan-bangongting-diaoyanshi. *Chengbaozhi de fazhan yu wenti yanjiu* [A study of the development and problems of the contract system] (Beijing: Zhongguo-caizheng-jingji-chubanshe, 1988), pp.211-15.
- 13 According to D. Granick, there is no correlation between the amount of profit earned by Chinese enterprises and the salaries and wages paid to their employees. This is because Chinese supervisory authorities have no objective criteria for assessing enterprise performance. See D. Granick, *Chinese State Enterprise: A Regional Property Rights Analysis* (Chicago: University of Chicago Press, 1990), pp.187-189; As I pointed out in the text, uniformly applying objective criteria would not accurately reflect excellent or poor enterprise performance when irrationalities in the pricing system prevail. Enterprise performance inevitably has to be assessed in accordance with the individual situations of given enterprises.
- 14 Wu Jinglian, "Jingji tizhi gaige mianlin de nandian he chulu" [The hardness faced by the economic structure reform and its way out], *Caimao jingji*, 1988, No.3, p.10.
- 15 Zhongguo-jingji-nianjian-bianjiweiyuanhui, ed., *Zhongguo jingji nianjian, 1989*, pp.III-1-2. According to this source, transformation of state enterprises into joint stock companies, while being an important item in the reform program, is still at a primitive stage.
- 16 Du Haiyan, "Chengbaozhi: guoyou qiye tizhi gaige de chushi xuanze" [The contracted system: an initial choice in reforming the state enterprise system], *Jingji yanjiu*, 1987, No.10, p.10.
- 17 Yang Luilong, "Chanquan mingxihua yu shuangceng gufenzhi moshi" [Obviousness of the property right and model of the twofold shared ownership], *Jingji yanjiu*, 1988, No.2, pp.3-4.
- 18 Tian Daigui, "Zhengque renshi he pingjia chengbao jingying zerenzhi" [Correct understanding and assessment of the contracted management responsibility system], *Caimao jingji*, 1988, No.4, p.56.
- 19 Du, "Chengbaozhi," p.18.
- 20 Xue Muqiao, "Guanyu jingji tizhi gaige wenti de tantao" [Tentative study on the reform of the economic system], *Jingji yanjiu*, 1980, No.6, pp.9-11.
- 21 Kyōichi Ishihara, "China's Multiple Price System," *China Newsletter*, No.80, 1989.
- 22 Diao Xinshen, "Guanyu Zhongguo shuanggui jingji de fenxi" [An analysis of China's dual-track economy], *Zhongguo: fazhan yu gaige*, 1989, No.12, p.15.
- 23 Dong Fureng, "Jingji yunxing jizhi," p.29.
- 24 *Renmin ribao*, May 14, 1987. A similar situation exists with the six enterprises in Beijing surveyed in 1985 [Nigel Campbell, "Enterprise Autonomy in the Beijing

- Municipality," in *Management Reforms in China*, ed. Malcolm Warner (London: Frances Pinter, 1987), pp.58–67].
- 25 Zhao Renwei, et al. "Shichanghua gaige jingcheng zhong de shiwuhua qingxiang" [On the tendency of paying in kind in the course of market-oriented reformation], *Jingji yanjiu*, 1989, No.4, pp.4–5.
 - 26 State Statistical Bureau, ed., *Zhongguo tongji nianjian*, 1989.
 - 27 *Jingji ribao*, July 18, 1987.
 - 28 *Jingjixue zhoubao*, June 12, 1988.
 - 29 Fanzhan-yanjiusuo-zonghe-ketizu, "Zhongguo de fazhan: caifu zengzhang yu zhidu shiying" [The China's development: wealth growth and system adoption—On the new stage of growth of national economy again], *Jingji yanjiu*, 1988, No.5, p.32.
 - 30 He Pengju et al., "Sichuan zhigong shouru fenpei qingkuang ji qi duice" [Income distribution to staff and workers and its countermeasures in Sichuan province], *Jingjixue dongtai*, 1989, No.10, p.26.
 - 31 *Renmin ribao*, February 24, 1988.
 - 32 Hua Sheng, Zhang Xuejun, and Luo Xiaopeng, "Zhongguo gaige: huigu, fansi he qianjing" [Ten years in China's reform: looking back, reflection, and prospect], *Jingji yanjiu*, 1988, No.9, pp.19–20.
 - 33 Xun Dazhi, "Gaige yu fazhan mianlin de maodun he wenti" [Contradictions and problems in the reform and development], *Zhongguo: fazhan yu gaige*, 1989, No.8, pp.10–11.
 - 34 Shen Liren and Dai Yuanchen, "Woguo 'zhuhou jingji' de xing-cheng ji qi biduan he genyuan" [Formation, defect, and origin of "the economy divided by dukes or princess under emperor" in China], *Jingji yanjiu*, 1990, No.3, pp.15–16.
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 - 40 Liu Renxiu and Zou Bailin, "Qiye duanqi xingwei chuyi" [A humble study on the shortsighted behavior of enterprises], *Jingji guanli*, 1990, No.3, p.26.
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- 43 *Caimao jingji*, 1991, No.3.
- 44 Reeitsu Kojima, *Chūgoku kin'yū shijō no tajūsei* [The multilevel system of the Chinese financial market], in Kyoichi Ishihara ed., *Chūgoku keizai no tajū-kōzō* [The multilevel structure of the Chinese economy], Institute of Developing Economies, 1991, pp.192-93).
- 45 *Jingji ribao*, July 8, 1992; *Suenbou* (Hong Kong), June 19, 1992.
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- 47 Guojia-jingji-tizhi-gaige-weiyuanhui-zonghe-guihuasi, ed., *Zhongguo gaige dasilu* [Major flow of thought on China's reform] (Beijing: Shenyang-chubanshe, 1988); Kyōichi Ishihara, "Keikaku seido" [Planning systems], in *Chūgoku sōran* (Tokyo: Kazan-kai, 1990); and Toshio Tajima, "Seisaku to riron" [Policy and theory], in *Chūgoku nenkan* (Tokyo: Chūgoku-kenkyūsho, 1989), p.98.
- 48 Wu Jinglian, "Guanyu hongguan jingji wenti de fenqi" [Different opinions on macroeconomic problems], *Jingji yanjiu*, 1987, No.11, p.52.
- 49 *Shijie jingji daobao*, November 3, 1986.
- 50 Shehui-kexueyuan-jingji-xuekejian-jingji-xingshi-fenxi-ketizu, "Zouchu kunjing de jinqi duice" [Short-term counter-measures to extricate from difficult conditions], *Jingji yanjiu*, 1989, No.7, p.6. This group of authors includes Dai Yuanchen, Liu Guoguang, Zhang Zhuoyuan, and Zhou Shulian; Dai Yuanchen first raised his point about promoting reform in parallel in *Shijie jingji daobao*, November 10, 1986. (Kyōichi Ishihara, "Kakaku kaikaku" [Price reform] in *Chūgoku sōran* [Tokyo: Kazan-kai, 1988]).
- 51 The disturbance on August 10, 1992 caused by the clumsy handling of stock sales in Shenzhen is another example of this situation.
- 52 Chen Yizi, *Shinian gaige yu bajiu minyun* [China: ten years' reform and the democratic movement in 1989] (Taipei: Lianjing-chuban-shiye-gongsi, 1990), p.126.
- 53 *Renmin ribao*, June 2, 1988, disclosed that an organization to examine price reform had been set up. This group consisted of representatives from the State Planning Commission, the State Commission for Restructuring the Economic System, and the State Price Bureau, other ministries and bureaus under the State Council as well as the Policy Research Center of the Secretariat of the Communist Party of China.
- 54 *Gaige shibao*, July 30, 1991; *Shiryō Nitchū keizai* [Japan-China economic data] (Tokyo), August 1991, p.6.
- 55 The separate tax system has been introduced to Zhejiang Province, Liaoning Province, Xinjiang Autonomous Region, Tianjin Municipality as well as Wuhan, Qingdao, Dalian, Shenyang, Chongqing since 1992. Fixed revenues for the central finance are composed of customs duty as well as the excise tax, value-added tax, industrial and commercial consolidated tax, special consumption tax, and others collected by customs in behalf of fiscal agencies. Agricultural and animal husbandry tax, fair trade

- tax, bonus tax, regulatory tax on individual income and others belong to fixed revenues for the local finances. General excise tax, value-added tax, turnover tax, industrial and commercial consolidated tax, taxes on the possession of resources are separated to the central and local finances. The rate of separation is eighty for the localities with twenty for the center in national minority areas and fifty-fifty in the other areas (*Renmin ribao*, June 20, 1992).
- 56 Under the envisaged new system, however, there will be a need to differentiate between the two. To overcome this difficulty, in September 1992 the Chinese leadership decided to abandon the nomenclature "state-run enterprise" and use only the term "state-owned enterprises."
- 57 On May 15, 1992, several provisions including "Normal views on limited liability companies" and "Measures for trial implementation of joint-stock enterprises" were promulgated (*Renmin ribao*, June 22 and 16, 1992), but these contain no detailed rules and regulations for the management of state-owned enterprises under a joint-stock system. 3,220 joint-stock companies (not including the joint-stock cooperatives of township and village enterprises, joint ventures involving Chinese and foreign investment, and domestic joint ventures between different ownerships) were established by the end of 1991. Of these companies 2,751 (86 per cent) have issued stock to their own employees, while 380 (12 per cent) have adopted the holding company system and only 89 (2 per cent) have sold stock to the general public.
- 58 Zhang Jixiang, "Lun jianli woguo xinxing de shehuizhuyi guoyou zichan guanli tizhi" [Establishing the new system for socialist state-owned assets management in our country], *Zhongguo gongye jingji yanjiu*, 1991, No.2, p.30; *Zhongguo gongye jingji yanjiu*, 1992, No.7, p.18.