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China

Economists on Reform Issues, Economic Problems

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China

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GAIGE [REFORM] No 2

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Planning, Socialist Commodity Economy
40060556a Beijing GAIGE [REFORM] in Chinese
No 2, 20 Mar 89 pp 5-7

[Article by Xue Muqiao 5641 2550 2890: "Planned Management Is Central to the Socialist Commodity Economy"]

[Text] Editor's note: What is the basic cause of the grim economic situation facing China today? Of all the reforms in the last decade, which should be affirmed in theory? Which should be furthered, developed, or reexamined? In practice, which policies and measures should be affirmed? Which are misguided or wrong? At stake in all these questions is the future course of Chinese reform. Recently the editorial department of this publication invited scholars and experts from the theoretical community in the capital to attend several seminars. Their speeches are excerpted below in the hope that they will shed further light on the above questions.

Planned Management Imperative in a Socialist Commodity Economy

China's socialist economy is a planned commodity economy. Thus there must be a planned management system based on a commodity economy. In the past we often thought that a planned economy and a commodity economy are mutually exclusive and that a socialist economy is a planned economy from which a commodity economy is excluded. Now it seems such thinking is mistaken. Socialist countries, too, need to establish a planned commodity economy and create a new socialist commodity economic order. After their commodity economy attained a high degree of development, capitalist nations also have been forced to draw up assorted economic development plans to regulate and control the macroeconomy. As far as I know, countries like Japan and France all practice economic planning. Other capitalist countries also draw up strategic plans for national economic development and carry them out through indirect regulation and control, as by fiscal means, although they do not call such activity economic planning. Yet other nations may sing the praise the *laissez-faire*, but they too must formulate some fiscal and monetary policies to effect macroeconomic regulation and control.

From the 1950's through the 1970's, developed capitalist nations tried to ward off a slowdown in investment and economic recession through deficit budgeting and by tolerating mild inflation. By the late 1970's, inflation shot up sharply, endangering the market and the stability of the economy as a whole. In the 1980's, these countries began tightening the money supply by an appropriate degree and stabilizing prices to ensure steady economic growth. When an imbalance appears in the development of the various sectors of the economy, the government would manipulate the tax system and tinker with the credit policy to steer enterprises back onto the path it desires. As they shift from a product economy to a

commodity economy, socialist countries too must master indirect regulation and control to ensure a balance between aggregate social output and aggregate demand and proportional development between the sectors of the national economy.

From the 1950's through the 1970's, China practiced planned management based on the product economy. Enterprises carried out production and exchanged social products in accordance with the national plan and at prices set by the state. Since there are myriad social products and the market supply-demand relationship is ever changing, this kind of planned management often results in a divorce between production and market demand. Moreover, the value (cost plus average profit) of a product changes all the time, as does the market supply-and-demand situation. Official prices thus reflect neither value nor the supply-demand relationship. Many products in short supply are underpriced, while popular products are overpriced. The failure to correct underpricing and overpricing promptly has led to disproportionate growth between the different sectors of the national economy.

Since the 3d Plenary Session of the 11th CPC Central Committee, we have been trying to reform this irrational planned management system by gradually giving more decisionmaking authority to localities and enterprises and deregulating the prices of numerous commodities, at the same time keeping a tight leash on the scale of capital construction and adjusting the proportionate relations of the various sectors of the national economy. Only 5 years later, we have had many achievements and adjustment has largely been a success. At the 3d Plenary Session of the 12th CPC Central Committee in 1984, the socialist economy was declared to be a planned commodity economy. The 13th National Party Congress in 1987 demanded that planning be based on commodity exchange and the law of value, thus completing on a theoretical level the transition of the guiding principle behind planning from the product economy to the commodity economy. A planned management system based on the commodity economy must gradually reduce the scope of command planning and expand that of guidance planning. To put it differently, indirect economic tools such as prices, taxes, and credit should be used to achieve macroeconomic regulation and control.

Since the 3d Plenary Session of the 12th CPC Central Committee, the scope of command planning has been substantially reduced, although unaccompanied by a corresponding expansion in the scope of guidance planning. We still have not mastered the two tools of macroeconomic regulation and control: fiscal policy and credit policy. Fiscally, we cut taxes and allowed enterprises to keep a larger portion of their profits in order to spur their initiative as well as that of localities. As far as bank credit is concerned, we raised the ceiling on lending and expanded the scale of construction. As a result, lending got out of hand. Although the national plan declared year after year that a "double-tightening" policy would be

pursued, what we have had in fact is a double-relaxation policy. The upshot is worsening inflation. The 3d Plenary Session of the 13th CPC Central Committee adopted a new policy—rectify the economic environment, restore economic order, and intensify reform across the board in order to regain control on the macroeconomy, in effect setting the stage for another round of adjustment. The hope is that “rectification and restoration” will bring down inflation and create the conditions for price reform and the open policy in the future, thus paving the way for reform intensification all round.

These are the lessons in the area of planned management we have learned from a decade of reform:

First, the old planned management system, which was based on the product economy, shackles the development of productive forces, prevents production from meeting market demand, and interferes with the improvement of people's living standards. Thus we must develop a planned commodity economy, establish a new socialist commodity economic order, and put planning on the basis of a commodity economy.

Second, the socialist commodity economy must also be accompanied by strict planned management. The difference is that guidance planning will gradually replace command planning. In the case of a handful of key capital construction projects and the production of raw materials in short supply, such as energy and steel, command planning will always remain necessary. But other projects and other forms of production will gradually come under guidance planning.

Third, whether it is command planning or guidance planning, it should be centrally managed by the national government. The difference is that in the case of command planning, the central government resorts to direct management and issues orders directly to localities and enterprises. Under guidance planning, no orders are issued to enterprises. Instead, the state regulates and controls indirectly through fiscal, tax, and credit policies and other macroeconomic control methods.

Fourth, pricing is the most important economic tool for regulating the supply-demand relations of various products. Reforming the irrational price system is the key to the success of economic structural reform as a whole. The ultimate means of price rationalization is price deregulation (with the exception of a few monopolistic prices such as electricity rates and rail freight) and reliance on the market to regulate prices through the law of value. This is the only way to make prices reflect value as well as be consistent with the supply-demand relations on the market. On the other hand, price deregulation must go hand in hand with an effort to curb inflation. Inflation leads to the depreciation of the currency and across-the-board price increases. When prices rise too fast, people become dissatisfied, forcing the state to

reimpose control on prices that have already been deregulated. The upshot is a new set of price distortions, which will impede the intensification of reform.

Fifth, fiscal and tax policies are also a vital means of applying economic leverage. When investment dries up and the economy slides into a recession, the state cuts taxes to encourage investment. When there is an excess of investment and the economy becomes overheated, the state raises taxes to keep investment in check. To encourage the production of goods which are in short supply and need to be developed, the state cuts taxes as an incentive. Conversely, to discourage over-production in other lines of products, the state raises taxes. To be an effective regulator, the product tax must be directly handled by the central Ministry of Finance. If it is collected by the localities, it may produce the opposite result: Local governments scramble to expand the production of high-tax products, while balking at the production of low-tax products.

Sixth, more important than even fiscal and tax policies as a means of economic leverage is the bank credit policy. When investment withers and the economy is headed for a recession, banks increase lending and lower interest rates to encourage investment. When there is overinvestment and the economy is overheated, banks cut back on lending and raise interest rates to roll back investment. Industries that need to be developed should be given more loans at lower interest rates. Industries that need to be curbed should be denied credit or given less credit at higher interest rates. Accordingly, banks must be given decision-making power and authorized to operate independently free from the interference of local governments. When prices are soaring, interest rates on loans and deposits must be raised promptly. If interest rates are lower than inflation, deposits will drop and borrowing will increase, thus further fueling inflation.

Seventh, the most important function of national planning is to ensure a balance between aggregate social production and aggregate demand. Its second function is to ensure proportional development between the various sectors of the national economy in accordance with the nation's industrial policy. A national plan must ensure balances in the budget, in credit incomes and expenditures, in the supply and demand of goods and materials, and in foreign exchange incomes and expenditures. If the government ends up with a budget deficit and loses control on lending, the inevitable outcome is inflation. And once inflation reaches a certain point, price stability will be jeopardized, which does not bode well for the effort to further reform overall.

Eighth, to establish a new socialist commodity economic order, we must keep a tight lid on the money supply and deregulate prices. This is the only way to reform an irrational price system, make full use of market mechanisms, and enable all enterprises to compete freely on a level playing field so that the strong will survive and the weak will be weeded out. This is the road the national

economy must travel if it is to be modernized. Price deregulation must be premised on reining in the money supply. If we lose control on the money supply, which will lead to inflation, the government will be forced to reimpose price control. That will derail reform and even may even force it to retreat, something which must be avoided to the best of our ability.

Retrenchment, Structural Adjustment

40060556b Beijing GAIGE [REFORM] in Chinese
No 2, 20 Mar 89 pp 7-8

[Article by Liu Guoguang 0491 0948 0342:
"Retrenchment and Structural Adjustment Must Go
Hand-in-Hand"]

[Text] In the current drive to rectify the economic environment, we have again stumbled upon the "two difficulties." As a result of the strict adherence to retrenchment, cash flow difficulties in society are multiplying, causing circulation bottlenecks and a "decline" in production. On the other hand, if we give up retrenchment, a new round of runaway inflation will ensue and gallop out of hand. What is to be done? It seems that the only way out is to adhere to retrenchment in aggregate terms while pushing hard for structural adjustment. There is nothing novel about this proposition, but carrying it out does require a tremendous amount of resolve and effort.

Actually this is not the first time we ran into the "two difficulties." We encountered this in 1986 after we adopted a retrenchment policy the previous year. At the time we had to retreat from the goal of aggregate retrenchment in response to a noisy clamor over the difficulties in circulation and production. Rumbles were heard even in the theoretical community, where some alarmists were saying that the retrenchment policy had caused losses in national income totalling hundreds of millions of yuan. An even louder chorus of complaints came from localities, sectors, and enterprises strapped for cash. So we loosened the money supply—and unleashed a new and worse round of inflation in the following days. I think the current retrenchment drive will be dogged by similar complaints, and they will get louder and louder. The question is whether we can stand our ground in the face of such pressure. If we waver, the scenario of early 1986 will repeat itself and a new bout of inflation will break out, only this time it will be even worse. Moreover, because of our failure to grasp the opportunity to overhaul the irrational and highly inefficient economic structure, its serious and lingering problems are bound to deteriorate as inflation persists, possibly bringing about long-term stagflation. Clearly that is something we would not like to see.

To stand firm on aggregate retrenchment successfully, we must make use of the opportunity presented by retrenchment to effect a structural adjustment. One reason why our last effort at retrenchment fizzled out is because we imposed one single policy "rigidly across the

board" and failed to combine retrenchment with structural adjustment. In fact, retrenchment is an excellent time to achieve structural adjustment. In Western market economies, major economic shake-up often occurs in the downturn of the economic cycle. It is during that period that overcapacity is got rid of, along with the more inefficient parts of the economy, in a natural process of elimination. Our economy is dominated by public ownership. Why can't we make use of the golden opportunity presented by the current retrenchment drive to adjust the economic structure responsibly and in a planned way by eliminating overcapacity and those parts of the economy which are unsound and inefficient?

There seems to be little opposition to structural adjustment these days. In fact, it is much talked about. However, it seems to me that the public has insufficient understanding of and is not psychologically prepared for the hefty price and enormous sacrifice that structural adjustment will exact. It must be realized that if we do not remove the myriad large and small trouble spots accumulated over the years, and eliminate a host of duplicated imported projects and numerous inefficient or low-efficiency enterprises which are simply a waste of energy and resources, we will not be able to ensure that those enterprises that are truly efficient will be able to expand instead of cutting back in lean times—which must happen if they are to optimize production structure and take the road to rationalization and high efficiency. In short, only by eliminating the deadwood can we help preserve and promote those enterprises that should survive and prosper. There is no way we can climb out of the valley in which we now find ourselves without paying a steep price. But the mentality these days is this: Don't worry, be happy; let the good times roll. But people fail to see the superficiality of the good times. If we leave the tumor alone, especially the tumor on ourselves, how can we rectify the economic environment, restore economic order, and weather the current crisis? What we need to do now is to instill in everybody from top to bottom a readiness to put up with the hard times ahead. In the next 2 to 3 years everybody must put up with the hardships of belt-tightening conscientiously, including a drop in real living standards, and overcome the crisis together. This way the central policy of "rectifying the economic environment" will be achieved. There is no easy way out. Yet such awareness is lacking among the general public today. Many people think that we will be able to muddle through just by slowing things down a little. This kind of thinking is worrisome. Should we all succumb to such thinking, orders concerning rectification and restoration will not be followed through and prohibitions will not prohibit. There may be policies coming from the top, but people below have their own countermeasures. Take social institutional purchasing, for instance. The plan last year was to reduce it by 20 percent. As it turned out, it actually shot up 20 percent compared to the year before. If this is true for all retrenchment measures, the prospects of rectification and restoration should be a cause for serious concern. Thus the mentality that we can ride out the crisis in ease

and comfort absolutely must be changed. Instead we should foster the idea that the entire populace must be ready to make temporary sacrifices in order that we can survive the crisis together.

Needless to say, to insist on retrenchment in aggregate terms and tackle structural adjustment requires the coordination of many related policies and measures. Numerous operational details have yet to be worked out. But the most important thing remains an unshakable resolve and tenacity to go through with rectification and restoration. If all of us from top to bottom have such resolve and tenacity, fully appreciate the enormous significance of setting the economic house in order, are fully prepared ideologically to pay the price that weathering the crisis will entail, and do a good job in coordinating the policies, then we will certainly be able to accomplish the mission of rectification and restoration put forward by the CPC Central Committee after 2 to 3 years of conscientious hard work and advance reform and the open policy one step further.

Reform Difficulties

40060559 Beijing GAIGE [REFORM] in Chinese
No 2, 20 Mar 89 pp 9-11

[Article by Dong Fureng 5516 6534 4356: "Ideology, Politics, and Culture Impede Economic Structural Reform"]

[Text] Chinese reform is now 10 years old. A decade of practice has furthered our understanding of reform. At the beginning of reform, we were full of enthusiasm. A decade later, we need to do some hard thinking about it. At the beginning of reform, we were full of dreams about reform. A decade later, we should examine it more critically. At the beginning of reform, we tended to believe reform was relatively easy. A decade later, we are more aware of its arduous and long-term nature. Reform is beset with difficulties, of which only the more glaring ones will be briefly discussed here.

Judging from the present situation, the greatest difficulty seems to be one of ideology. The early days of reform saw an ideological liberation movement aimed at liberating our ideas from the shackles of "leftist" thought and theories and removing the ideological roadblock to reform. That was a tall order. It has turned out to be very difficult indeed to rid ourselves of the fear of independent thinking, which had built up for years, and the inertia that had predisposed us toward quoting others, being too lazy to think for ourselves. As reform intensified, however, discarding leftist ideas and theories has turned out to be far from sufficient. What we must do is to reexamine even those socialist theories which have not been distorted by "leftist" influences but which clearly contain simplifications, fantasies, and misinterpretations of socialism (such as the idea that there is no commodity or currency in the socialist economy). Such socialist theories took shape when capitalism was under attack and when socialism was in some ways inconsistent

with modern capitalism. So we need to reexamine both socialism and capitalism. Since such reexamination requires that we break with some theories that have been regarded as classic and that have not been distorted by the left, it is more difficult than liberating ourselves from the fetters of leftist ideas in the early days of reform. We can expect to run into more ideological hurdles. To surmount such hurdles, we sometimes have no choice but to invoke the very theories we need to rise above in order to prove that abandonment does not go against "reason." Our ideological difficulties render us extremely cautious as reformers.

Then there is the difficulty related to political institutions.

In the early days of reform, we were ignorant of the kind of problems our political system could cause for economic structural reform. Little did we know then that the political system was the very thing that the old economic system depended on for its existence and operation. Not only did it have an independent existence transcending the economic system, but it was also meshed with it, forming an integrated whole. Take, for instance, the fusion between government and enterprises. You can say it is a political system. Or you can say it is an economic system. Superficial economic structural reform probably does not affect the political system, but economic structural reform that is remotely thoroughgoing is bound to undermine the foundation of the old political system and therefore cannot be carried out in the absence of political structural reform. The more intensive economic structural reform is, the greater a barrier the political system becomes. Just think: Economic structural reform requires first and foremost that the market be developed and perfected. Yet right now layer upon layer of local blockade is getting worse. Certainly the economic system is partly to blame for this. Still such blockade cannot have come about without a political system in which political decisionmaking power is concentrated in layer upon layer of authorities from top to bottom. Economic structural reform cannot succeed if it is not coordinated with political structural reform. That much everybody recognizes today. But political structural reform is as difficult as economic structural reform.

The difficulties of economic structural reform can also be found in the economic system itself. Here it might be useful to quote a common saying: It is harder to alter a piece of old clothing than to make a new one. Where do the difficulties lie? Instead of going into detail here, let me just make a few points:

A network of vested interests has developed under the old system. Economic structural reform necessitates the destruction of the existing network of vested interests and its replacement by a new pattern of interests. Yet everybody hopes to benefit, not suffer, from reform. They object to reform, even when short-term and special interests are disturbed in order to further the long-term general interest. People embrace reform in theory but are reluctant to go along when their own interests are affected. For instance, everybody knows that the iron

rice bowl lies at the root of poverty and that as long as it exists, we cannot hope to get rich. However, when one's own iron rice bowl is in danger, one balks at reform and even declares righteously, "There should be no unemployment under socialism." (Until recently we did not even have the courage to mention unemployment, preferring instead to say "waiting for employment.") If everybody is to benefit from reform in equal measure (the so-called "keep-up-with-the-Joneses phenomenon"), then how can we reform? A few years ago, there was a proposal to raise the retail price of a box of matches from 2 to 3 fen so that match factories would not lose money and would stay in the business. The decisionmaking department agonized over this for a long time. If it was this insignificant to raise the price of a box of matches by 1 fen, imagine what it would be like to make other changes.

The old economic system is an entity made up of related parts. We cannot wake up one morning, sweep away the old system lock, stock, and barrel, and put a new system in its place. We can reform only step by step, only one part at a time. And that has been giving us problems. Every step of the way, reform has run into resistance from the old system. Not only does the old system try to resist and reject the new system, but it also distorts it in the process. We can compare this situation to the inability of a machine and a newly installed part to work together or to the rejection by a human body of a newly transplanted organ. An example of the failure of the old and new systems to work together concerns the contract system under which new workers are hired. The contract system is designed to bring the market mechanism into the labor system and smash the iron rice bowl. But the original permanent labor system remains in place, with workers hired under the old system still accounting for over 90 percent of all workers. Apart from the permanent workers, the state is also responsible for allocating jobs for and taking care of over 1.8 million workers. Under these conditions, it is rather difficult even for new workers governed by the contract system to circulate freely. The act of signing a contract has become a mere formality, with no essential difference between permanent workers and contract workers. Besides, at a time when the social insurance system is still in its infancy and far from perfect, the strict enforcement of the contract system will create its own set of problems. Situations like this are legion in reform. Without appropriate coordinated measures, any one piece of reform is unlikely to produce the anticipated results. In fact, its negative effects may outweigh any positive outcome it may have. In our drive for a new economic system, the most tricky problem we have run into today is the failure of state-owned enterprises to develop into a microeconomic base where the market operates and our failure to bring about the coexistence of state ownership and market mechanisms. At a time when state-owned enterprises have yet to become major players in the market with decisionmaking authority and responsibility for their own profits and losses, and when such enterprises have yet to submit themselves to market regulation, any unilateral move to introduce and develop the market will not be as effective as it should and

may even lead to chaos in the economy. Inflation, which has been worsening lately, is related in part (not in whole) to this phenomenon.

What passes for reform goals in people's minds are often ideals or even theoretical models. To turn them into reality is a long difficult process. During this process, there are many occasions when objective conditions intervene and constrain. Let me cite just one example here. Many people agree that we need to create a market that operates under the guidance of planning. For such an economy to function smoothly, one prerequisite is a well-developed market. (There are other preconditions, but we will not discuss them here.) In putting together this kind of model, we have run smack up against the reality of economic backwardness in China: the continuing substantial presence of the natural and seminatural economy. Certainly, reform could remove the institutional barriers in the way of the development of the commodity economy and the maturing of the market and create favorable systemic conditions. But it cannot replace the transformation of the natural economy into a commodity economy or the historical evolutionary process of the development of a commodity economy on such a foundation. A backward economy and an underdeveloped commodity economy are the reality that we cannot but face up to in the long process of establishing a new economic system.

Finally, I want to point out the difficulties created for reform by social and cultural conditions. Cultural backwardness and many feudal natural economic traditions also impede economic structural reform. Let us leave aside the millennia-old tradition of slighting commerce and our traditional egalitarianism. The absence of a legal tradition makes it difficult to create a commodity economy. Breaking a contract, for instance, is not considered something serious. "Guanji," or personal connections, replaces the normal transactions and competition on the market. As for "official profiteering," that goes back a long time in Chinese history and was once a "booming business."

To say all this is not to suggest that reform in China is doomed. It does mean that we must realize its long-term and very difficult nature clear-headedly. We must face up to the problems and press ahead with reform persistently and unswervingly. To complain, blame others, and beat a retreat as soon as we run into difficulties and setbacks betrays at least a lack of understanding of the difficulties of reform and a lack of confidence and resolve needed to overcome those difficulties.

Seeking Truth From Facts

*40060559 Beijing GAIGE [REFORM] in Chinese
No 2, 20 Mar 89 pp 11-12*

[Article by Ma Bin 7456 6333: "Learn From Western Experiences Selectively"]

[Text] To achieve modernization, China needs to assimilate the modernization experiences of developed

nations. But this process of assimilation should be a selective and not an indiscriminate one. In its course of development, for instance, the United States moved from the manufacturing of durable goods (iron and steel, raw materials) to that of nondurable goods (such as television sets and refrigerators) and to commerce and retail trades, from manufacturing to services, from the production of tangible wealth to the trading of financial assets, from ordinary technology to high tech, and from low consumption to high consumption.

We lack iron and steel, nonferrous metals, oil, lumber, and electricity, yet we have been shifting from the production of durable goods to that of nondurable goods and from primary raw-material industries to consumer-goods-processing industries without careful consideration. We lack material wealth, yet we are seeking to develop financial assets. We are weak in the production of material goods, yet we are turning our attention to the service sector. We are still trying to grow enough food and vegetables and provide housing and clothes, yet there are suggestions that we shift to high consumption. It is a mistake to imitate the practices of developed capitalist nations blindly.

The quest for truth and overcoming blindness are the problems we must pay special attention to as we modernize.

The Chinese countryside boasts a huge population. When we want to develop industry and the service sector by taking advantage of the growing agricultural sector and a rising productivity in agriculture, we should draw upon local resources as much as possible, making and selling things locally. This is the way to develop agricultural processing industries and service industries related to agricultural products. When these industries have been put on a sound footing and when other favorable conditions become available (e.g., transportation and the opportunities for export), we can then develop other industries, in the process providing nonagricultural jobs for surplus agricultural workers. To what extent we can successfully steer these workers into nonagricultural employment is conditional upon improvements in agricultural productivity. In the Great Leap Forward, 60 million people were sent to the mountain areas and went into steel smelting in large numbers. Agriculture was neglected, even ruined. This was no way to bring about industrialization. It only resulted in sham industrialization.

There are massive hydropower stations, thermal power plants, and nuclear plants in developed Western nations. In some of these countries, they are using artificial light to replace sunlight and building underground shopping centers. To make money, they are not concerned to save electricity but to think of more ways to consume electricity. Many of our factories have to stop operations several days a week. They do not pay attention to energy development. On the contrary, they turn out domestic electric appliances blindly. They neglect primary industries, energy, and transportation. Instead, they develop

processing industries thoughtlessly, particularly consumer-goods industries that make TV sets, refrigerators, beer, and disposable cans.

Service industries must be developed as part of modernization. They serve production, for one thing, and improve living, for another. Service industries must be profitable and earn foreign exchange. But even in the West, service industries took off only after the economy had developed and there was money in the hands of the people. Moreover, people went into the service sector to make money, not for petty trivial reasons. In China, people everywhere are splurging on all kinds of projects. Even Buddhist temples are being built. We have outdone the West: There are proportionally more luxury hotels in China than in the West.

The finance industry, too, must be developed. In developed countries, both government and nongovernment banking institutions are well established. Be that as it may, new rules are constantly being written to regulate the financial assets markets (among those assets are deposits, stocks, and bonds.) Right now the American stock exchange is governed by over 300 regulations. China does not have a sound accounting system or the basis of a banking system. Even savings deposits, lending, and foreign-exchange account settlements are ridden with flaws. But the absence of a company law and other rules and regulations has not deterred us from trying to set up a stock market and futures market. In imitating foreign countries this way, we are not really developing a banking industry, only messing it up.

To achieve modernization, we must raise the people's living standards and improve consumption. But it is totally unjustifiable to copy the West's wasteful pattern of consumption and even outdo it. Quick turnover, rather than durability, is the main concern in the manufacturing of articles of daily use. In clothing manufacture, they stress endless novelty. So-called brand-name liquors, perfumes, and cosmetics, as well as fashion shows, are advertised on TV, wasting the time of the audience.

It should be pointed out that in order to compete and survive, capitalists in the West are very education-, quality-, and variety-minded and take great pains to improve technology and lower costs. Because of our overall low educational standards, we seem to have ignored this point, namely the need to shift from low quality to high quality, from old varieties to new varieties, and from low technology to high-tech.

Not South Korea, however. South Korea has pursued a correct industrial policy and boasts a sound industrial structure. They have refused to follow the West blindly. They mastered the manufacturing of color TV sets but there were no color TV stations in Korea until 4 years after the nation became an exporter of color TV sets. Not only do they refuse to drive foreign cars, but they export cars on a large scale.

We cannot operate in isolation from objective material conditions. With our feet firmly on the ground, we must improve our productive forces significantly instead of doing things that are long on style but short on substance.

Proper Relationship in Reform

40060560 Beijing GAI GE [REFORM] in Chinese
No 2, 20 Mar 89 pp 12-15

[Article by Wu Xiang 0702 6272: "Rectifying the Economic Environment Will Help, Not Hinder, Reform"]

[Text] A decade of reform has produced historic achievements which are now the focus of world attention. But reform is also confronted with a string of new problems and difficulties. In recent years, in particular, the economy has been overheated, demand has been overstimulated, prices and inflation have been soaring, distribution has not been equitable, and corruption has appeared. All this has caused widespread concern. Ideologically too there has been some confusion. The 3d Plenary Session of the 13th CPC Central Committee has decided to concentrate on improving the economic environment and rectifying the economic order for a period of time, a move both correct and necessary.

Is such improvement and rectification necessary? On this there is a national consensus, from top to bottom. The problem is how we interpret and implement the central policy of improvement and rectification. Everywhere we can see that there are two markedly different philosophies, attitudes, approaches, and results. One is the philosophy of the product economy. In other words, people judge the current problems and difficulties by the standards of the product economy. In analyzing a situation, they are often puzzled by a certain phenomenon and lose sight of what is really important, unable to arrive at an overall judgment that is in line with objective realities. In strengthening macroeconomic regulation and control, they consciously or unconsciously tend to rely too much on the old approach of administrative intervention and go too far in the direction of centralization and uniformity. This approach is often inefficient and even counterproductive, exacerbating problems instead of ameliorating them. In some cases, it works temporarily but really provides no basic solution and may actually create problems for reform and the open policy in the future. The other philosophy is the philosophy of the commodity economy, that is, people judge the new problems and difficulties from the new perspective of the commodity economy. In analyzing a situation, they emphasize seeing through a phenomenon to get at the essence of a problem and arrive at an overall judgment that is in line with objective realities. In strengthening macroeconomic regulation and control, they advocate the extensive application of all applicable tools, particularly economic instruments and market mechanisms. Even when there is no alternative to emergency measures like price control and state monopoly, even when methods contrary to the law of value have to

be resorted to in order to check growth rates that have exceeded the tolerance of all social quarters, they are careful to limit them to the smallest extent and take advance actions to ward off any potential side-effects. The pay-offs of this approach may not be immediate, direct, or noticeable, but by improving the economic environment, rectifying the economic order, optimizing the industrial structure, and increasing effective supply, it helps pave the way for further reform and more openness as well as easing the most acute difficulties facing us right now. No doubt we should follow the latter philosophy, adopt the latter attitude and set of practices, and work hard to vitalize the microeconomy by strengthening macroeconomic regulation and control, promote the development of the socialist commodity economy, and avoid resurrecting the old economy by reintroducing an excessive measure of control into a newly revitalized economy. Unfortunately, people who operate according to the first philosophy not only have plenty of company but also exert a good deal of influence. A number of leading cadres also judge and handle problems in accordance with the first philosophy. Under these circumstances, it is inevitable that the CPC Central Committee's policy of improving the economic environment and rectifying the economic order has come to be misunderstood to various extents. It is seen as a negative policy that will militate against reform and the open policy and is solely concerned to reduce the scale of capital construction, scale back projects indiscriminately, and tighten credit. In fact, improvement and rectification should be a positive policy that would benefit reform and the open policy. Under this policy, leading cadres at all levels are required to come to grips with reality, keep up with the ever-changing situation, and do their best to proceed from realities and handle problems realistically and correctly. Projects that should be scaled back should be scaled back, while those that should be scrapped, preserved, or expanded should be treated accordingly. Only thus can we clear up misunderstanding, dispel public doubts and uneasiness, improve public morale, and press ahead vigorously.

There is more discussion about prices than about anything else in society these days because they affect the personal interests of every single individual. Why do prices go up? Inflation, we may say. Why do we have inflation? Because the economy is overheated. This begs the question: Why is the economy overheated? Time and time again? Because we never learn from the past? Hard to say. However, I believe that since inflation has been a recurrent social economic phenomenon over the past few years, it clearly has less to do with a few individuals and more to do with the economic management system. China is so poor, so backward. Who does not want a faster pace of economic development? Thus we cannot simply blame everything on economic overheating but should do some detailed analysis. Which sectors of the economy are overheated? Which sectors are developing briskly without being overheated? Which sectors are languishing instead of being overheated? Between 1980

and 1987, capital construction investment in the state-owned sector of the economy increased from 50 billion yuan to over 130 billion yuan, for an average annual increase rate of 12.5 percent. Investment in heavy industry and light industry rose 14.7 percent and 9.99 percent, respectively, each year on the average. In contrast, investment in agriculture dropped 3 percent annually. What does this investment pattern suggest? That agriculture is a higher priority than heavy industry? Or is it the other way around? Is the economy overheated? Or is industry overheated while agriculture is being neglected? What are we suffering from—a case of flu or an attack of malaria, giving us chills and fevers, often at the same time?

Under the planned-product economy, enterprises did not have sufficient decision-making authority, were not held responsible for their profits and losses, and could not operate independently. When they incurred losses, the state would make up the difference. Since responsibilities, rights, and interests were not integrated, these enterprises could not be as dynamic as township enterprises. Strictly speaking, our old economic system was one in which nobody assumed economic responsibility. This system gave rise to a host of devitalized, unprofitable, and unenterprising enterprises and created a climate that encouraged the exclusive pursuit of output value and a fast growth rate, while ignoring economic efficiency and profitability. This is one of the root causes of the recurrence of economic overheating. Therefore, we must reform the old economic management system and create one in which the "state regulates the market and the market guides enterprises." In other words, apart from a number of special major projects that impact the economic lifeblood of the nation, the state should not give direct orders to enterprises through planning. Instead, it should regulate and balance through the market and prices and operate in accordance with the law of value. However, historical circumstances have ruled out the establishment of a unified market system in the near future, let alone the creation of a powerful market mechanism anytime soon. We have barely finished putting up the framework of the new system and still have a long way to go before the system becomes a functioning coordinated whole. Meanwhile the old system continues to play a role, even a leading role, in many arenas, often powerfully supported by forces of habit and social psychology. Consequently, a variety of contradictions and conflicts will inevitably arise in the transitional period from the old to the new. This is an unavoidable long painful process, independent of man's will. Moreover, it is not going to last a mere 3 to 5 years, or even 8 to 10 years. We must understand this clearly and be fully prepared for it ideologically. Otherwise we will all too readily let a little success go to our heads or feel defeated with the smallest of setback.

There are many reasons for the variety of contradictions and conflicts that appear in the period when the new system replaces the old. To me, there are two basic factors: One has to do with material interests. After more than 30 years, the planned product economy has not only developed into a full system, complete with its own

institutions, procedures, work methods, and styles, but it has also become a relatively stable interest structure. Economic structural reform necessarily touches upon every person's vested interests. While reform will ultimately bring more benefits to more people, it affects every individual differently in different ways. If a person benefits from reform in four areas but suffers from it in one, he would still feel dissatisfied. This may be the reason why people "pick up the rice bowl and eat meat, put down the rice bowl and curse their mothers." In addition, it is unavoidable that there will be certain inappropriate policies and measures in the course of reform which unjustifiably damage the interests of the public, thus further exacerbating the conflicts.

An even more basic factor has to do with ideas and thinking. Feudalism is deepseated in China, with its civilization and history going back thousands of years. In the last 100 years, China was reduced to a semi-colony subject to imperialist aggression and oppression, which resulted in a profound hatred of capitalism. After the PRC was founded, leftist errors multiplied, which distorted public understanding of socialism, removing it from reality. As a result of the interplay of all these factors, we were not sufficiently prepared in reform theory and our thinking was confused. We often preserved and adhered to things unfavorable to the development of productive forces, assuming that they were socialist principles, while criticizing things favorable to the development of productive forces as if they were capitalism. The most glaring and significant problem revolves around the commodity economy. For years we were wont to regard it as diametrically opposed to and mutually exclusive with socialism. We also equated it with capitalism and even branded it as the most dangerous form of capitalism. And capitalism was our enemy—counterrevolutionary, a dead end, an utter failure, something that must be resisted firmly and destroyed completely. Then came reform and the open policy. We opened our door to take a look outside and realized that it isn't so. Not only are other people much more advanced than us in science, technology, and enterprise management, but they have also established a sounder legal system and created a superstructure suited to a sophisticated commodity economy. The concepts of commodity, capitalism, and efficiency have struck a deep root in the hearts of their people, creating a social climate where members of society are encouraged to work hard to better themselves. In short, they are rich, we are poor; they are advanced, we are backward. Thereupon some people swung to the other extreme as if we were inferior to other people in everything and capitalism were perfect. They lost confidence in socialism and yearned for capitalism. Then there are those who blame the current numerous difficulties and negative phenomena on reform, the open policy, and the commodity economy. In fact, the opposite is true. The real problem is that reform has not been coordinated, the open policy has not been thorough, and the commodity economy has not been fully developed. The result is a transitional period from the old to the new when all kinds of conflicts proliferate, complicating the intensification of reform. We absolutely cannot blame this on the backward thinking of

the masses. Our current problems are in essence the penalty we must pay for closing the country to international intercourse for years, for parochial arrogance, and for rejecting the commodity economy, a leftist error. Years of practice prove that practicing socialism while rejecting the commodity economy is bound to lead to socialism that creates mass poverty, to a sham socialism. Post-reform practice also proves that provided we correct leftist errors, practice reform, implement the open policy, and integrate socialism with the commodity economy, the situation will change fundamentally and the superiority of socialism will gradually manifest itself.

The resolution on economic structural reform adopted by the 3d Plenary Session of the 13th CPC Central Committee points out that "the socialist economy is a planned commodity economy on the basis of public ownership." This scientific judgment is a most important breakthrough and development in the history of Marxism and constitutes the cornerstone of the theory of the initial stage of socialism. It should be regarded as the guiding thought of reform and the open policy. The first step in rural reform benefited from the discussion about practice being the sole criterion of testing truth. Through discussion, the most basic idea of historical materialism became deeply etched in public consciousness. Once the masses grasp a theory, it becomes an enormous material force. Although the socialist commodity economy has been explicitly written into Central Committee resolutions and studies have been organized, there has not been enough propaganda to instill it in the minds of the people. As a result, the concept of the commodity economy has neither struck root in the hearts of the people nor become their guiding idea, a fact that helps explain the practical difficulties and ideological confusion we are now experiencing. If the key to the achievement of the four modernizations and the revitalization of China is the fostering of a sense of modernity and modern ideas, the eradication of old ideas, thought, and habits, and the overhauling of the old economic management system, then the key to successful rectification and restoration also lies in the uprooting of old ideas, thought, habits, and styles related to the product economy and the establishment of new ideas, concepts, and style related to the commodity economy. If we all realize that the socialist economy is a planned commodity economy and assess and handle problems accordingly, we will speak a common language and be able to resolve many conflicts and contradictions.

Speeding Up Agricultural Reform

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[Article by Zheng Zhong 6774 6850: "Decade of Agricultural Reform Produces Mixed Results"]

[Text] Agricultural reform in the last decade was a success. Yet the prospects for rural development, particularly agricultural development, look grim. Agricultural and rural issues must be considered in the overall context of the national economy and urban-rural relationship. If devise and implement a strategy that balances agriculture with

industry and cities with the countryside, and rely on the intensification of reform and scientific progress, China's agricultural and rural problems can be solved completely.

In the early days of rural reform, agricultural output soared for several subsequent years. Total grain output increased from 300 million tons in 1978 to 400 million tons in 1984. For a time there were surpluses in some regions and sectors. Significant increases were also recorded in other major crops. Although grain production languished after 1985, gross agricultural output rose sharply in the 9-year period from 1979 to 1987. The total output of cotton, oil, sugar, meat, aquatic products, and fruit all doubled or did better. Never in history had per capita availability been higher. The net incomes of peasants more than tripled.

During the 10 years of reform, the rural cooperative economy introduced a production responsibility system revolving around the family output-related system of contracted responsibility. The state raised grain procurement prices and opened up country fair trade. Peasants were given decisionmaking authority in their operations and reaped tangible economic benefits, which boosted production initiative tremendously. This was the main driving force behind rural development. At the same time, we should bear in mind that an average of 10 million tons of grain was imported each year for 5 consecutive years during this period, creating the necessary conditions for the recovery of the countryside and the adjustment of the production structure. The achievements of scientific research, accumulated for years, were widely applied. There was also a substantial increase in the supply of industrial goods for use in agriculture, including chemical fertilizers, electricity, and farm machinery, where gains of 100 percent, 83 percent, and 66 percent respectively, were recorded. Farmland capital construction, the product of several years of hard work, ensures that these inputs, human, intellectual, and material, were used efficiently. In the early years of reform, when diversified operations in the countryside were still a thing of the future, peasants devoted themselves heart and soul to working the contracted cultivated land and expanding agricultural production. During this period, in short, the state gave agriculture strong protection and support, at the same time correcting "leftist" errors. In agriculture, expanded reproduction is also conditional upon additional material resources.

Since 1985, grain output has been stagnating. In 1988, there was a broad decline in the output of grain, cotton, and oil, the nation's top three agricultural crops, which between them account for about 88 percent of total cultivated land. This is a danger signal signifying that the call by agricultural departments in 1986 for boosting the momentum of agricultural development had gone unheeded. Investment in agricultural capital construction has continued to decline. True, we had an exceptionally large number of natural disasters last year, which only shows that our farmland is becoming less and less resistant to flooding and drought. Many areas have fallen

back to the level of the early 1970's. The demand for agricultural capital goods has exceeded supply. The ability to disseminate agricultural science and technology at the first front has weakened tremendously. State procurement prices for such crops as grain and cotton are far too low. All this forms a sharp contrast to the overheated economy. Also, grassroots organizations in some rural areas are not well organized. As a result, peasants have no one to turn to when they run into production difficulties. Their production has been seriously undermined by inequitable and unsound distribution in society. The CPC Central Committee and the State Council consider agriculture a priority and have taken decisions to ensure a bumper harvest this year, which are now being implemented by all localities and departments as they improve the economic environment and rectify the economic order.

To sum up, if the problems in agricultural development are not resolved in earnest, we face the danger of a decline in grain production. Should that come to pass, not only would agriculture be forced to return to monoculture, but it would also become a drag on industrialization and even affect social unity and stability.

The prospects for agricultural development are grim. One reason is the limits on water and land resources. But we face an even more formidable task in dealing with the hundreds of millions of agricultural workers shifting from agricultural to non-agricultural employment as agriculture moves toward modernization. Between the founding of the PRC and 1978, the ratio of industrial output value to agricultural output value changed from 3:7 to 7:3, indicative of significant industrial development. However, the ratio of urban to rural population has remained unchanged at 2:8, as has that of the industrial labor force to the agricultural labor force. (This phenomenon calls for a detailed analysis.) The result is that a massive redundant labor force is still languishing in the countryside, primarily cultivated land, hampering agricultural modernization. Hence our extremely low productivity in agriculture. In economically developed nations, grain production per farmer can be as high as 100,000 kilograms and usually ranges from 30,000 to 50,000 kilograms. In China, it is only a little over 1,000 kilograms. Modernization cannot rest on traditional agriculture; there is just no alternative to agricultural modernization. In economically developed nations today, the agricultural labor force constitutes less than 10 percent of the population. Suppose China achieves the current world average of 40 percent. It means that 200 rural workers would have to find employment outside agriculture. The transfer of agricultural labor force on this scale is unprecedented in history. But it is an historic task that must be accomplished. It will necessarily involve making choices regarding the overall national economic development strategy and can never be solved by agriculture itself in the countryside.

At a theoretical level, we already established back in the 1950's the guiding thought of "taking agriculture as the

base and industry as the leading factor" and the principle of formulating national economic plans in accordance with these priorities: agriculture first, then light industry and heavy industry. In practice, however, we have always followed a development strategy partial to industry. Because of the wide price scissors between industrial products and agricultural products, agriculture has provided the state with funds amounting to hundreds of billions of yuan. Between 1953 and 1980, fixed assets investments by the state totaled 500 billion yuan, of which 75 percent went to heavy industry, 8 percent to light industry, and 17 percent to agriculture. More was taken from agriculture than was put back in it. Proportionate relations exist in the development of the various sectors of the national economy. Such relations are not subject to human will. The distribution of funds and material resources must be consistent with these relations. Otherwise, structural imbalances will ensue. After the PRC was founded, the industry-agriculture growth ratio has fluctuated as follows: 1953-1978, 1:3.9; 1979-1984, 1:1.3; 1985-1987, 1:4; and 1988, 1:7. This shows that structural imbalances in the national economy have been worsening again. Therefore, if we fail to review experience from the level of national economic development strategy, agricultural modernization will not materialize. Moreover, short-term agricultural problems will deteriorate. On the other hand, if we review experience from the strategic level and take care to strengthen macroeconomic regulation and control, we will more effectively resolve some of the problems in economic life as well as in agriculture itself.

We must formulate and implement a development strategy that seeks the balanced development of industry and agriculture, of urban and rural areas. We must find a proper place for agriculture and the rural question in the agenda, not in theory, but in practice. The intensification of rural reform remains a herculean task. The continued adjustment of the rural industrial structure and the simultaneous commercialization, modernization, and cooperative transformation of agriculture will take time, probably lasting throughout the initial stage of socialism. Rural cooperative economic organizations should be improved. The family should remain the operational unit and should expand the scale of operations as the agricultural labor force moves into non-agricultural employment. The extent of agricultural mechanization should be increased. Traditional agricultural technology should be combined with its modern counterpart to significantly improve agricultural production and land yields. In light of the needs of commodity production development, we should support the peasants in coming together to solve pre-production, production, and post-production problems that a family or household cannot solve on its own. Without changing the position of the family as the unit of operations, we can organize joint operations combining agriculture, industry, and commerce, which can be either comprehensive or specialized, in order to expedite production growth. There is much talk these days about serving peasants. At the head of agricultural-industrial-commercial joint operations is

usually a state-owned enterprise or institution, but this is only a matter of form. We should encourage the peasants to get organized on their own to serve themselves, forming communities of shared economic interests that can take care of every link in the production process—processing, distribution, or circulation—within the limits of the cooperative, thereby reducing intermediate links and conflicts now in existence. When peasants join forces and make agricultural production more organized, they help bridge the gap between decentralized agricultural production and the development of a unified market for agricultural products. A national cooperative network built from the bottom up will be an excellent and important communication channel between the state and peasants, a bridge between macroeconomic regulation and control and microeconomic activities. In this area we may learn from the cooperative-organizing experience of small and mid-sized farmers in some developed countries.

The imbalance in inter-regional economic development and the specialization of commodity production determine that regions vary in the degree of cooperative transformation and that cooperative economic organizations be diversified in format. This is an objective law of development. The current crazy-quilt of cooperative organizations and associations, which are known by an array of names and are of varying degrees of cohesiveness, reflects the true level of the commodity economy in China. Under no circumstances should we spoil things with excessive enthusiasm and impose one uniform policy rigidly across the board. That would be repeating an old error. We should respect the peasants' creative spirit and provide guidance according to the circumstances to promote the commercialization, modernization, and cooperative transformation of agriculture.

Problems, Solutions of Reform

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[Article by Wang Jue 3769 3778: "Problems in Reform and the Way To Solve Them"]

[Text] The reform is presently in a serious situation: Production development has overheated, the industrial structure has become unbalanced, demand has increased excessively, inflation is serious, signs of corruption are widely prevalent, the masses are ideologically confused, the attractions of reform and opening up have rapidly vanished, etc. How are we to understand these problems in the present reform? Opinions differ widely. For instance, as regards an understanding of the nature and degree of these problems, some believe that the present predicaments are of a seriousness never before experienced since the founding of the PRC. Some believe that the four cardinal principles are presently on the verge of complete collapse. These views are obviously contrary to facts. We certainly must be clear about the seriousness of our present problems, but they are problems that have emerged in the course of overall economic development

and deepening development of reform and opening up. These problems, furthermore, no matter how serious they may be, are still secondary if viewed from the standpoint of the overall entity and overall situation, and are completely controllable and solvable. And again, as to an understanding of the causes for these problems, some believe them to have been created by reform, opening up, and the development of the commodity economy. Others believe that they are due to mistakes in the major decisions made during reform and opening up. Although not completely baseless, these views are still not the result of a realistic and well-founded understanding. I believe gaining an accurate knowledge of the reasons for the various serious problems that exist nowadays is a precondition for the correct implementation of the policy set forth by the 3d Plenary Session of the 13th CPC Central Committee, namely of "improving the economic environment, rectifying the economic order, and comprehensive deepening of the reform." It is also the new starting point from which the national economy as well as reform and opening up will move forward in a sound development. I shall therefore discuss here mainly my understanding of these issues.

In my opinion, the real causes for some of the serious problems in the reform are:

First, a situation has arisen in the course of 10 years of reform, in which two systems, the new and the old, confront each other. This confrontation of two systems not only engenders friction and breeds conflict, but prevents both from exercising their normal functions and leaves cracks in the whole system. This will inevitably lead to loss of macroeconomic control and distortions in microeconomic actions, and these are also the fundamental reasons for the overheating in the manufacturing industries, the excessive increase in consumption demand, the extremely high rate of inflation, and the widely prevailing corruption. It has to be pointed out emphatically that while neither the new nor the old system can fully exercise their normal functions, the many shortcomings of the old system have resurfaced in greater force. Especially the evil practice of "eating from the big pot," that is peculiar to state ownership, the foundation of the old system, we may say, is the chief source for some of the serious problems of the present time. On this basis, it is not difficult to understand why the various problems that have arisen in China's present reform have all also appeared sooner or later, and in varying degrees, in the reform of other socialist countries, namely because basically the foundation of the old system in all these countries has been essentially the same.

Second, the reform of the economic system and economic development have not been appropriately integrated. In concrete terms, the shift from old to new system in the structural reform and the shift from the old to the new model in the economic development have not been appropriately integrated. The shift from the old system of product economy to the new system of commodity economy demands and promotes a transformation in economic development from the old speed-oriented model to a new efficiency-oriented model,

because this is the only way in which the promotive effect of the structural reform can be activated, and, in another respect, that the economic development can provide the material foundation for a deepening of the reform. As a consequence, we must have both supplement each other, have both constitute cause and effect for each other, and have both develop jointly. As we correctly set forth a policy according to which the reform was to involve the entire situation as a whole, we neglected or did not take effective measures to satisfy the needs of the shift from old to new system. Speaking of the structural reform itself, since the growth of the new system has not yet been able to unsettle the foundation of the old system, which if the practice of "eating from the big pot," it has also not been able to exercise a promotive effect on any shift in the developmental model, as far as property rights are concerned. As a result, the shift from old to new system and the shift in the developmental model have become disjointed. This has caused a serious imbalance in the industrial structure and in the economic development, an extreme state of confusion in economic operations, and a drop in economic efficiency that is hard to mend, and therefore also created the difficult situation which prevents the smooth and deepening development of the reform.

Third, failure to coordinate urban and rural reforms. China's economic structural reform has had its start in the rural areas. Since the 3d Plenary Session of the 11th CPC Central Committee, two measures—raising grain prices and instituting the output-related contractual responsibility system—have radically changed the structure of the rural economy. The true essence of the transformation was that it opened up a passageway for the shift in the rural areas from natural economy to commodity economy. In less than 5 years, grain production was doubled. However, after 1984, when the focus of the reform shifted from the rural areas to the cities, no adequate solution was provided for the problem of how to integrate urban and rural reforms and to have them promote each other, and, furthermore, to arrive at a common deepening of the development. This has worked as a restraint on agricultural production, especially on the development of grain production, which, conversely and inevitably, also acted as a restraint on the development of industrial production, led to shortages in the market, and to the rise in commodity prices.

Finally, insufficient theoretical preparation of the reform, and deficiency of the necessary close integration of theory with practice. Viewed from the standpoint of basic theory, we have to say that our reform has been carried out under the guidance of Marxism. The basic theoretical guidance that was put forward during the period from the 3d Plenary Session of the 11th CPC Central Committee to the 3d Plenary Session of the 13th CPC Central Committee has been: The theory of the central position of the productive forces, the theory of focusing on modernization, the theory of socialism with Chinese characteristics, the theory of planned commodity economy, the theory of the initial stage of socialism,

the theory of criteria for productive forces, etc. That means, that the basic purpose of the reform is the development of productive forces, that the objective of the reform is to establish a commodity economy with Chinese characteristics, and that the criterion for judging whether anything in the reform was correct or erroneous is whether it has been able to promote the development of productive forces. It is therefore under the guidance of the above-stated basic theories that our reform has been carried out, and in this sense we may say that our reform has indeed had theoretical guidance. However, from a different point of view it seems that the theoretical foundation for our reform has been insufficient. This mainly manifests itself in that the applied and concrete theory is not deep-going and systematic, and in that the concrete reform methods and measures lack full and specific theoretical proof. It was therefore inevitable that certain reform measures and methods were irrational and vacillating. An even more conspicuous problem is that some important decisions failed to integrate theory and practice, and as a result showed poor continuity and consistency. A clear manifestation of this is that although the 3d Plenary Session of the 12th CPC Central Committee issued such correct resolutions as "make enterprise reform the central task," and "price reform is the crucial point," these problems were not at all well resolved in the later practice, the main reason still being that there had been no clear theoretical proof provided, so that the practice was hesitant and indecisive, bungled the good chance, and delayed solution of the problem, thereby creating the situation that we are facing today.

A matter that is worthwhile pondering in particular is the problem of enterprise reform as central task. In 10 years of reform, the enterprise reform has all along never left the old rut of administrative decentralization, and the problem of separating government administration from business management has essentially never been solved. The basic reason for this is that we have never shown determination to apply a modern enterprise system to transform the state-run enterprises, and have shown even less courage to effect changes in the traditional forms of the public ownership system, but have tried to solve the enterprise problem by decentralization and giving up profits to the enterprises on the basis of the old forms of property management.

In short, theoretical laxity and inconsistency has led to hesitancy and vacillation in practice and prevented reform from developing in depth.

Through an understanding of the problems that exist in the current reform and of the causes of these problems, I have come to believe that one way to break through the difficulties is to control the currency inflation on the basis of control of the excessively rapid growth of demand; to cool down the excessively overheated speed of economic development on the basis of an adjustment of the industrial structure; to rectify the order in the area of circulation on the basis of strengthening the rule by

law; and on the premise of deepening the reform, effecting an appropriate integration of all other complementary reforms, of the regulation of the environment, and of the development of the economy. It is most important that we must not set solution of the present problems in hostile opposition to deepening the reform, and it is even less permissible to place our hopes for solving the present problems on the revival of old systems. That has to be made absolutely clear and must not be treated perfunctorily.

After extensive debate, the 3d Plenary Session of the 13th CPC Central Committee put forward the guiding principles of "regulating the economic environment, rectifying the economic order, and comprehensive deepening of the reform." The principles conform to the reality of the situation and are therefore correct. Of course, these principles must be comprehensively and correctly explained. In my opinion, the principles, expressed in 18 Chinese characters, must as a whole incorporate the spirit of the reform. Not only must the "regulating" and "rectifying" lay the foundation for a deepening of the reform, but the "regulating" and "rectifying" itself must as far as possible adopt correct methods, or methods which at least do not obstruct the reform. This is the only way of effecting a comprehensive deepening of the reform, as otherwise the comprehensive deepening of the reform would amount to nothing but empty words.

Regulating the economic environment, most importantly checking inflation, requires retrenchment of investment in capital constructions and in production enterprises, which both hamper rational development of the industrial structure. We must at the same time strictly control and reduce unproductive consumption demand, which is detrimental to economic development and to stimulating enthusiasm among the workers. However, as to the methods to be employed, we must as far as possible adopt measures that will prove beneficial for reform, and as much as possible refrain from using administrative measures that impede or abrogate reform. Whether they are economic measures or actual administrative measures, they should as far as possible gradually assume the form of legal measures, in a transition from "rule by individuals" to rule by law; this in itself is a major reform.

In rectifying the economic order, the key point is directing our main attention to the area of circulation, the rectification of market order. For this purpose, it is necessary to strictly suppress illegal official and private profiteers, and at the same time to rectify certain companies of an administrative nature that engage in illegal commodity circulation, also to impose restrictions on all reckless raising of prices, etc. But if we merely stop at actions against economic crimes and control commodity prices by state sales monopolies or administrative measures, this would still be applying superficial cures, and would not solve the problem once and for all. There is still need for a radical cure, for instance, continuation of the reform of the price structure, and the gradually

abolition of the double-track system of prices, establishing a new market system under plan guidance, and squeezing out all profiteers from all market operations, instituting reform of the monetary system and the tax system, and promoting rationalization of the industrial structure as well as remedying the problem of unfair distribution, establishing a modern system of enterprises, reforming the ways in which the public ownership system appears and changing the ways in which public assets are managed, and radically breaking up and eliminating the basis and operational mechanism of the old system. This is the only way to enable true establishment of the new order of socialist commodity economy. Above statements show that the process of rectifying the economic order is actually a process of deepening the reform. Both are completely one and the same thing. It would be a horrendous mistake to place rectification and reform into position of hostile confrontation, or even to regard rectification as cancelling out reform.

Comprehensive deepening of the reform means that deepening the reform must not merely consist of assaults on certain individual targets, but must be action that takes place comprehensively over the whole area. It should not only comprise reform of the economic structure, but there should be coordinated action of reform and development, urban reform must work in concert with rural reform, economic structural reform shall be coordinated with political structural reform, etc. In this way, deepening the reform is not only arduous but also complex. One must therefore not expect immediate results or be impatient for quick successes. There has to be a protracted process of well coordinated development, which means a process of integrating economic stabilization, reform, and development. In concrete terms, there has to be a close integration of theory and practice, an integration of the solution of actual problems with the objectives being pursued in reform and development. Very obviously, it would be unrealistic to set a very short time limit for the duration of this process. It is my opinion that we must be prepared for a struggle of long duration, lasting 3 or 5 years, or even longer, for the fundamental resolution of our current problems, and for further progress in the deepening of the reform. From "deep in the mountains among raging torrents, seemingly without any way out" to "a new village with shady willows and beautiful flowers."

Causes of Current Economic Difficulties
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[Article by Yang Qixian 2799 0796 0341: "Don't Blame Present Economic Difficulties on Reform"]

[Text] Since last year, serious difficulties and problems have indeed arisen in China's economic life. For instance, industrial production has increased at an excessive speed, and economic life is increasingly suffering from shortages; the commodity price index is continuously rising, and inflation is evidently getting worse;

market order is in confusion, and social distribution is unfair; power play intrudes into business, and official profiteers abound; there is increasing corruption among party and government cadres, etc., etc. Resentment in all quarters is very strong and is becoming a threat to economic and social stability. It is for this reason that the CPC Central Committee has resolved to implement a policy of "improving the economic environment, rectifying the economic order, and comprehensively deepening the reform." This is absolutely correct.

The present occurrence of these difficulties and problems has been analyzed in different ways, which is normal and understandable. However, one view, namely that they have been mainly created by the reform, or even that they are the consequence of mistakes committed in the reform, is in my opinion incorrect and harmful, because it is a view that is divorced from the subjective and objective conditions of China's present-day economy and oversimplifies its complex problems. It is a view that is, on the one hand, harmful to the consolidation of all achievements made during 10 years of reform, and harmful to affirming the determination and confidence of the people in the further progress of the reform, as it is also harmful, on the other hand, to a comprehensive summing up of experiences and to the earnest search for the correct way to extricate ourselves from these difficulties.

On realistically analyzing the situation, I believe there are at least the following five causes for our difficulties:

First, despite 10 years of reform, the shortcomings of the previous system have not yet been effectively eliminated. As a socialist country, China has very early instituted the system of public ownership of the means of production. However, China has never established a set of clear responsibility-power-interests relations under the conditions of the public ownership system. This allowed those making decisions to be free from bearing responsibility for consequences, those in managerial positions to "eat from the big pot," and the workers to trust their "iron rice bowls." As a result, everybody in the economic field, be it unit or individual, was constantly out to only expand without any self-restraint. Production and construction became "overheated," there was a constant shortage of supplies, and the macroeconomic balance was generally in a state of disruption and seldom properly adjusted. Whenever the equilibrium of accumulations became seriously disturbed, circumstances compelled them to make ad hoc adjustments. This was definitely done more or less once every 3 or 4 years, at most every 5 or 6 years, moving in this way back and forth in circles, almost without end. Beginning in 1953, when the Soviet system of planned economy was emulated in every respect, we have gone on in this way for 30-odd years. For instance, in the years 1953, 1956, 1958, 1960, 1966, 1970, and 1978, after the overexpanded scope of constructions, high industrial growth rate, and reckless inflation of demand led to imbalances in major portions of the economy and serious imbalances, we have used 1 or 2

years, or even several years, to carry out such readjustments. The present problems are only a recurrence of shortcomings of the traditional system. For instance, in 1984 the central authorities clearly pointed out that investments in the construction of fixed assets had been excessive, and demanded suspension of work for the next 3 years, with basically no further expansions. However, during the following 3 years not only was there no halt, but construction increased by about 80 percent. Industry showed too fast a growth rate, and this was pointed out in 1985, but the growth rate has never been reduced. The 1985 plan included 294 billion yuan of investments in construction and an 8 percent industrial growth rate, but actual investments were in excess of 430 billion yuan, and the industrial growth reached 17 percent. This year had the largest excess over plan norms in recent years. It led to an even more serious macroeconomic imbalance, to larger inflation, continuous rises in commodity prices, and confusion in the market. It gave some people opportunity to fish in troubled waters, distribution became unfair, and it caused anxiety among the people, so that the situation compelled them to make resolute retrenchments and readjustments. This is a necessity, as it is also the main cause for China's present economic difficulties.

Second, the slowing down of increases in agricultural production, reduced production of major agricultural products, recurrence of the incongruity in the proportionate relations between industry and agriculture. China is a large country, but although the territory is so vast, its population also exceeds 1 billion, so that the per capita arable land is only 1.5 mu. The elasticity coefficient for increased agricultural production is very small, and the impossibility of relying on imports to solve the problem of shortages of major agricultural products is one of the major negative factors that constantly impedes China's economic development. Systematic reform in the rural areas during the period from 1979 to 1984 stimulated peasant enthusiasm as it had not been stimulated for many years, and activated agricultural potential as it had not been activated for many years. Agricultural production increased very quickly, and its average progressive increase reached 7.8 percent per year, while the average progressive growth of industry during the same period was only 9.6 percent, so that the proportion of comparative growth rates was 0.81 to 1, and agriculture and industry maintained essentially the same growth rate. At that time, agricultural supplies were, therefore, available in sufficient quantities, commodity prices were essentially stable, living standards of the urban and rural populations rose quickly, and the masses were very happy. But in the last 4 years, agriculture changed from conditions of above-normal to normal increases, as the average annual progressive growth rate dropped to 3.8 percent. On the other hand, the industrial growth rate during the same period rose to 17 percent, and the proportionate relative growth rates widened to a 0.22 to 1 ratio, even larger than the 0.25 to 1 ratio during the period of the First 5-Year Plan. Especially in 1988, when natural disasters curtailed production of major agricultural products, such as grain, cotton, and oil crops, the overall growth rate of agricultural production dropped to 2.2

percent, while the growth rate of industry again rose and reached 17.7 percent, which again increased the disparity in the relative growth rates between the two branches to 0.12 to 1, an unheard-of low in all history. Most conspicuous is the situation in grain production, which has continuously vacillated during the last 4 years, with total production not only not increasing, but even declining. With the additional fact that the population increased by over 60 million during this period, the amount of grain per person declined from 800 jin to about 720 jin. As a consequence, the contradiction between industrial and agricultural production again tended to become strained. Supply of certain important products could again not keep up with demand, grain market prices doubled and redoubled, leading to increased inflation and inevitably to large price increases for products related to grain, such as meat, poultry, eggs, and vegetables. Because staple and nonstaple food prices account for two-thirds of all commodity prices in the computation of the 18.5 percent overall price increase of 1988, the 1988 price increase is easily explained.

Third, large price increases in imported raw and semifinished materials, and the additional change to "substitution for imports" prices for certain products, drove product costs up. During the several years of reform and decontrols, China's economy has come increasingly under the influence of the international market. For instance, the total value of its import-export products accounted for the following proportions in China's GNP: only about 10 percent in 1978, but increased to over 28 percent by 1988, a ratio which is larger than that in the United States and also higher than that in Japan. The importation of certain particular important raw and semifinished materials, such as steel products, copper, aluminum, timber, chemical fertilizer, pesticides, and plastics, accounts for a substantial proportion of the total volume of consumption goods. Changes in supply and demand or in their prices in the international market, of course cause fluctuations in the domestic market and in domestic prices. In 1988, the import prices of these products rose in general about 20 to 50 percent, or even more, over 1987 prices. In addition, in order to reduce fiscal expenditure, some products, which used to be imported, but received state subsidies in their domestic production, were changed to the category of "replacement of foreign trade articles" and priced at what their actual import costs would be. This had of course the effect that prices rose steeply when these imported raw and semifinished materials were supplied domestically. It raised production costs for trades and enterprises that use these materials, and this in turn inevitably raises market prices.

Fourth, the reform is still in the process of being carried out, all sectors find themselves in a stage where new and old systems coexist, which is of necessity a period of many contradictions, loopholes, and much friction. In the area of production, for instance, prices have basically, or to the greatest extent, been decontrolled for agricultural production, township enterprises, collective

enterprises, private enterprises, the foreign-invested enterprises, and in the case of small state-run enterprises. However, large-scale state-run enterprises are to a considerable extent still administered directly by the state or by command-type planning. In the area of circulation, the exchanges and prices of approximately half the products are already determined by market regulation, but for another half of all products they are still fixed by the state, or are subject to plan regulation. In the area of distribution, we have carried out throughout the country such diverse methods as contractual financial undertakings between central and local authorities, contractual undertaking between the state and enterprises for turning over profits, fluctuating linkage in enterprises between total amount of wages and economic efficiency, and the contractual undertaking of foreign exchange earnings from foreign trade. Especially to alleviate the severe shock that could possibly have resulted from a one-time decontrol, we have instituted in many cases a "double-track" system of prices for one and the same product, namely state-fixed prices for the part within the plan and market-regulated prices for the part outside the plan, etc. These measures are beneficial but at the same time also detrimental. In one respect, they enable an early break-away from the previous ossified system, quick stimulation of enthusiasm among the local authorities, the enterprises, and among staff and workers, and they will promote economic development, but they may also possibly lead to certain regions and departments isolating and barricading themselves, pursuing various short-range actions, and obstructing the socialization of production and management. All these measures are therefore of a strong temporary nature. Furthermore, the beneficial and detrimental aspects can easily change, while in the beginning the beneficial aspects will frequently outweigh the detrimental aspects, after accumulating to a certain degree, the detrimental aspects will outweigh the beneficial aspects. Many of the disruptive events of 1988 prove that the shortcomings of certain measures, such as the "double-track" system of prices, have grown to serious dimensions. Once we had the idea that we could quickly resolve the problem through price and wage reform, but due to the immaturity of objective conditions, this idea could not be materialized. It is therefore the historical task that we are facing today to soberly analyze the various contradictions, on the one hand, recognize the side effects that have already been caused, and, on the other hand, skillfully guide action according to circumstances and impose the necessary restrictions, and study what effective measures are to be adopted, to encourage the gradual shift and advance toward the new system, and not to confine ourselves merely to criticism and faultfinding.

Fifth, the effect of being overanxious for quick achievements and of limited experience, some measures also show the defect of sluggish decision-making and partial mistakes. It was of major importance that in our guiding ideology, early in 1988, our assessment of the 1987 economic situation was too optimistic, and that we did not adhere to a policy of appropriate retrenchments that

should have been followed. The obviously excessive growth rate of industry, that had become apparent already in the first half of that year, we essentially still considered as normal, and we did not institute the necessary measures of cooling down the economy and imposing restrictions. We by far did not give sufficient attention to monetary measures which can be most effective in maintaining short-term economic stability, especially under conditions of commodity economy, and we were inept in using these measures. For instance, at the beginning of the year, the central bank did not insist on calling in the loans which the specialized banks had passed on, loans that should have been recalled, and this resulted in credit inflation during the first half of the year and serious shortages of cash in the second half of the year when cash was needed for the procurement of agricultural products. In the first quarter, it happened that bank deposit interests were far below the rising commodity price index, and it would have stood to reason to raise interest rates to stabilize the deposit situation and avoid a run on the banks, also to withdraw more currency from circulation, while at the same time interest rates for loans should have been raised to control currency demand. However, since we underestimated this operational law of commodity economy, and due to a wide divergence of opinions, the decision was much delayed. The matter was studied for 5 months, and only on 1 September was it decided to increase the interest rate for 1 year deposits by 1.44 percent, while the commodity index during that period of time had already risen by above 5 percent. Not only was no solution brought about in this inverted relation of interest rates and commodity prices, but the situation was further aggravated by the said decision which proved absolutely useless. In addition, an improper price reform propaganda and the influence of huge increases in prices for a few famous brands of cigarettes and alcoholic beverages, led to great anxiety among the people and in August brought about large-scale withdrawal of funds and panic buying. Deposit funds in banks not only did not increase, but saw an unprecedented decline in absolute figures. The situation only became stabilized when it was announced on 10 September that maintenance of purchasing value would be guaranteed for 3 year or longer term deposits.

The above facts indicate that the factors that caused China's present economic difficulties are very complex. There are the shortcomings of imperfect institutions and of an imperfect system, also reasons in the structural changes and in the reform. There is the pull from demand inflation, and also the effect of increased costs. There are reasons which by nature we share with other countries, and there are also the special circumstances of China's present condition. It is therefore absolutely impossible to cover all reasons with one phrase "caused by the reform." Only by an analysis along these lines will we be able to adopt appropriate measures that will be right on target, and will we be in a position to achieve the objectives of "improvement of the economic environment and rectification of the economic order," and to

ensure stable growth of the economy, as well as the further promotion of effective and feasible reform, promotion of the gradual shift in the economic mechanism, and to radically eliminate the causes for China's recurrent inflations.

Persistence of Economic Reform

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[Article by Wu Kaitai 0702 0418 3141: "Correct Understanding of the Present Situation; Firm Adherence to the Original Direction of the Reform"]

[Text] I shall discuss two ideas with regard to the present economic situation and the future course of the reform:

I. We must carefully analyze the characteristics of the present inflation; we must not underestimate the present economic difficulties.

The following are some of the special characteristics of the present inflation:

First, this is a one-time inflation with the special characteristic of being partially concealed. In a completely open market economy, inflation will very quickly and readily show up in the commodity prices. Once commodity prices go up, surplus currency will actually be "digested" and "absorbed." As long as the amount of currency in circulation is not further inflated, commodity prices will quickly become stabilized again. China's market has by now not yet been fully opened up. Within a certain scope, the state is still adopting administrative measures of price restrictions for commodities, so that inflation cannot have an immediate effect on commodity prices throughout the entire economy, and so that there will be not too much currency that will temporarily become surplus purchasing power. As a result, increases in the retail commodity price index will outwardly not appear very high. For the years from 1985 to 1988, they were 8.8, 6, 7.3, and 18.5 percent respectively. But the actual amount of new currency that was issued was very high. In the years from 1984 to 1988, a really startling amount of new currency was issued, namely 49.5, 24.7, 23.4, 19.4, and over 45 percent respectively. The accumulation of purchasing power in the form of surplus cash grew to huge dimensions, the process of absorption of this surplus currency became a protracted one, and absorption slowed down. Under these circumstances, it will require a much longer time to curb inflation.

Second, the present inflation comes at the same time agricultural production is stagnating and there is a shortage of agricultural products. After the abundant harvest of 1984, agricultural production vacillated and made no progress in the years from 1985 to 1988. Supplies of agricultural products, which constitute necessities of life for the people, became insufficient, and with the rampant inflationary conditions their prices were of course the first to go up. On the other hand, China is short of arable land, which is, furthermore, decreasing almost

daily, and this too makes it very difficult to quickly increase the supply of agricultural products. Having this combination of inflation and insufficiency of agricultural supplies is bound to increase the difficulty to "regulate the economic environment."

Third, the present inflation has structural causes. At the present juncture, when the new system is about to replace the old system, "investment starvation" and "consumption starvation" is in many areas getting worse. In recent years, there has been quite some improvement over the past in the financial resources and powers of the local authorities and enterprises, which enables them to raise investment capital of their own, and under the present conditions when the reform has not yet extended to the system of "eating from the big investment pot," there has been a growing tendency of an inflation in self-raised investment capital. The financial contract system has greatly strengthened the tendency toward local inflation of investment funds. The lack of independence of the banks has credits and loans become the major means that support the inflation of investment capital. At the same time, through the first stage of reform, the tendency of staff and workers to pursue their personal material interests has grown much stronger, but no self-restraining mechanism has so far taken shape within the enterprises. The former administrative measures of the state of regulating and controlling the growth of consumption funds have been weakened, while new regulatory and controlling measures have not yet gained sufficient power. Under these circumstances, there is also a strong tendency toward an inflation of consumption demand. In recent years, the government has at different times tried to control the inflation of consumption demand, but has never been able to actually curb it. Of course, if the government would have correctly faced up to the inflation in 1986-1988, would have resolutely eliminated the harmful influence of the "theory of the beneficial effects of inflation," and would have immediately adopted correct policies, inflation could have been controlled. In this sense, we may say that the major cause for the increasingly serious inflation during the last few years is mistaken policy decisions. However, a deeper reason for inflation is the structural problem. A real prevention of inflation requires going one step further in the reform and should include reforms of the system of public finance, the monetary system, the investment system, and the enterprise system.

The above-stated characteristics show that we must arrive at a complete assessment of the difficulty and the arduous nature of our task of stopping inflation. The whole process of regulation cannot be accomplished in a short time. For a simple cure of the outward symptoms, we shall have to expend great energy, and as to the cure of the roots of the evil, even more time is required. The policy of "regulation" and "rectification," set forth by the 3d Plenary Session of the 13th CPC Central Committee, is absolutely correct, and we must implement this policy with firm determination and unswervingly pursue it to the end.

II. On Future Reform

The present regulations, rectifications, and adjustments are not intended to change the overall principles and policies of the reform. On the contrary, they are to provide conditions that will facilitate a better pursuit of the reform. After the 3d Plenary Session of the 11th CPC Central Committee had set forth the policy of reform, the further formulations of the fundamental principles, direction, policy, and general ideas of the reform by the 3d Plenary Session of the 12th CPC Central Committee and the 13th CPC National Congress were absolutely correct. The problems that have arisen in recent years have been caused merely by certain mistakes in the specific implementation of the reform. From now on, the reform must, on the one hand, firmly uphold the original direction, principles, and policies, and, on the other hand, in my opinion, also give due consideration to the following problems:

A. In the course of the reform, we must not merely attach importance to microeconomic aspects and neglect proper management of the macroeconomic aspects. During the period from 1979 to 1983, our reform gave serious attention to macroeconomic balance and therefore achieved very smooth progress. After the focus of the reform was switched to the cities in 1984, insufficient attention was paid to maintaining the macroeconomic balance, and the lack of serious attention in this respect led to a recurrence of a large imbalance in the major proportionate relations and to complications arising in the reform. In recent years, some comrades have strongly called for the creation of a more relaxed environment. The basic spirit for this kind of proposal is the demand to maintain fundamentally a balance between total social demand and total supply in overall volume as well as in composition. In other words, it is a demand to maintain the "three large balances" or "four large balances." Facts have proven that these proposals are correct. At the same time as microeconomic activities are invigorated, it is necessary to give fullest attention to the proper management of the macroeconomic aspects; this is precisely the lesson of the last few years. When adopting the various reform measures, we must at the same time give consideration to the possible consequences they may have in macroeconomic respects, and must follow them up with the appropriate macroeconomic regulatory and control measures. This is the only way to ensure continued smooth progress in the entire reform. In my opinion, it is only by adequately maintaining the macroeconomic balance, that means, by maintaining coordination of the major proportionate relations, a matter which has been repeatedly emphasized in the past, that the price reform will no more constitute such an enormously difficult affair. As soon as we shall have attained our objectives in the regulations, rectifications, and adjustments, we can courageously attack our most critical problems and carry through our price reform.

To eliminate any gravitation of inflation toward the organizational system, it is in my opinion now necessary

to intensify our reforms of the financial administration, the monetary system, the investment system, etc. We must as quickly as possible replace the financial contract system with a system of separate taxation. Tax collection, i.e. the operation of this regulatory lever, must remain in the hands of the central authorities. We must as quickly as possible establish a vertical leadership system for banks, and eliminate the interference by local government personnel in credit and loan affairs. We must as quickly as possible establish and strengthen the system of state-owned property administration, provide it with capable cadres, and institute a system of managing state-owned property along economic lines. During the period of regulating and rectifying, the establishment of new macroeconomic regulation and control must be given priority and placed in the lead among work to be done.

B. We must devote time and energy to the further study of the problem of the specific form and operational mechanism of the ownership system of socialist enterprises, so as to have state-owned enterprises truly become commodity producers with great vitality. We have conducted many experiments during recent years and gathered much useful experience, but have not yet arrived at a standardized method that is generally acknowledged as successful. In our present society, a small group of people harbor the idea that the only "way out" for state-owned enterprises is privatization. Some have even suggested converting the assets of all state-owned enterprises into shares to be distributed gratis to staff and workers, especially also to allow "officials" of enterprises or with departmental responsibilities to get the best cut. After these officials have received a one-time distribution of shares, they will leave government service and become shareholders, and organize a board of directors according to the Enterprise Law. This will ensure that the cadre stratum now in power will become the "true promoters of the reform" (actually the promoters of privatization). Obviously, this is an indication of complete loss of confidence in the public ownership system. On the question of the ownership system, we are now facing a challenge, and we should not only in theory expound the superiority of the public ownership system, but also prove it by the facts of practice. We must seek out the best real occurrences of the socialist public ownership system and truly establish the superiority of the public ownership system over the private ownership system. This is an extremely important task in our further deepening of the reform.

C. We must guard against being overanxious for quick achievements and must maintain a steady pace as we advance. The problem of being overanxious for quick achievements has still existed in our economic development and construction of the last few years. In 1985, industrial production has shown an abnormal excessive growth rate, which some comrades welcomed as "signs of economic upswing." At a time when the necessary policy of retrenchments had not yet been in force for very long, proposals against the policy of retrenchment were voiced, claiming deficiencies in the method of retrenchment. Out

of keeping with the times, a high growth rate was being emphasized, which ultimately led to a dangerous situation. In reform activities too, there existed a mood of overanxiousness for quick results, as it was, for instance, demanded that the foundation for the new system should be laid within a short time. In fact, the perfection of the enterprise management mechanism, development of markets, the formation of indirect regulatory and control measures, all require considerable time to achieve. They cannot be accomplished within a short time. We must fully recognize the complex and arduous nature of the reform, and must work steadily to make stable progress. We must work painstakingly and do a solid job. We must always remember the "haste makes waste" lessons from our history. We must maintain the firm step of our advance and the steady pace of our progress.

In the theoretical field, it is my opinion that we must reject the following two erroneous viewpoints: One is the proposition that an appropriate measure of inflation is beneficial, and the other is the idea that privatization is a way out of the dilemma. Both of these erroneous concepts are the products of unthinking mechanical copying of certain Western economic views, without analytical and critical absorption of the useful and rational elements in Western economic thinking, but rather peddling their dregs. The first idea has already had a certain influence on party and government leaders and has had detrimental consequences. The second point of view, although rejected by the leadership, is stubbornly trying to show itself off, and has become an undercurrent which is a threat to the future prospects of the reform. It is my belief that we must purge all traces of these two viewpoints in our future reform.

Further Study of Reform Problems

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[Article by Yang Zhenjia 2799 2182 1367: "A Deepening of the Reform Requires Exploration of Nine Problems"]

[Text] In the 10 years of reform and opening up, guided by the correct line enunciated by the 3d Plenary Session of the 11th CPC Central Committee, China has practiced a planned commodity economy, and our great achievements in reform and construction have attracted worldwide attention. However, in the course of our advances we have also encountered difficulties, of which a major manifestation is the evident inflation that has occurred in China's economic life. From 1985 to 1987, the average annual rate of inflation was 7.4 percent every year, which in 1988 then steeply rose to 18.5 percent. Never before since the founding of the PRC has there been such a huge increase in prices. The main reason for the steep increases in commodity prices was the excess of total social demand over total social supply. This is the natural result of many years of economic overheating and excessive demand. At this time of shifting from the old to a new system, to effectively curb inflation within a short time, and to more effectively attain the objective

of "improving, rectifying, and deepening the reform," also to gradually realize the desired model of economic operations, namely of having "the state regulate and control the market, and the market guide enterprise," it is necessary during the present comprehensive deepening of the reform to further explore the following problems:

I. The Need To Perfect and Strengthen the State's Ability for Macroeconomic Regulation and Control

The state's ability for macroeconomic regulation and control depends to a very large extent on the financial resources available to the state. At present, the state's finances are burdened with the expenditure for key project allocations, capital for the technological transformation of enterprises, circulating capital for enterprises, and expenses for educational, defense, and administrative affairs. Production, construction, and reform cannot be detached from the state's financial support. However, the financial strength of the state is getting weaker and weaker. For 9 out of the 10 years of reform, the state's finances have been in the red, and if foreign borrowing were deducted from state revenue, they would be in the red every year. At present, the proportion of the state's fiscal revenue within the total national income has dropped from somewhat over 30 percent before reform to 22 percent. To ensure the smooth progress of reform and construction, the reform of the financial system must be such that it will benefit the state's adequate accumulation of necessary financial strength, i.e. that it will help gradually raise the proportion of the state's financial income within the national income to 28-30 percent. The proportion of fiscal income of the central authorities should be raised from the present less than 50 percent to 60-70 percent. The system of contractual financial undertakings should be transformed to a system of separate taxation, and the main taxes should belong to the central authorities, or should be jointly shared by the central and the local authorities, which would be beneficial for a radical curbing of economic overheating and for an effective rectification of the industrial structure.

Taxes are the main source of China's fiscal revenue, accounting for more than 90 percent of such revenue. But according to investigation by relevant authorities, over 50 percent of enterprises and over 70 percent of individually run factories and commercial enterprises are guilty of tax fraud and tax evasion, and this would call for efforts to improve tax collection and tax administration. As things are now, tax collections should particularly be increased in the area of circulation and for high income earners. This would not only increase the state's fiscal revenue, but would also be beneficial for the adjustment of unfair distributions in society. Only by increasing tax revenue and the state's fiscal revenue can the state's ability for macroeconomic regulation and control be enhanced, and can the various policies and measures of party and government be genuinely implemented.

Practice of the last few years has also proven that the role of the banking sector must be fully brought into play in

macroeconomic regulation and control. In the last few years, particularly last year, the loss of macroeconomic control manifested itself conspicuously in the loss of control over the scope of loans and over the excessive issue of currency. Due to the serious imbalance between loan returns and disbursements, and the low receipt and payments of bank loans, a huge disparity was caused between deposits and loans. Due to the excessive issue of currency, currency in circulation in the market at the end of 1988 was several times the amount in circulation in previous years. The state must, therefore, intensify its macroeconomic control over the total amount of new loans, must strengthen its norms for total amounts and composition of each loan, and must strengthen its control over the new issue of currency. To prevent confusion and loss of control, the state may also consider dividing all banking organs into two categories according to their functions, one to be a system for activities of a policy nature and one for activities of a commercial nature, so that each may attend to its own sphere of functions, and so that macroeconomic regulation and control be enhanced.

II. During the Reform We Must Guard Against the Occurrence of "Double Inflation," Namely That Inflation of Investment and Consumption Demand, That We Experience at Present, Will Evolve Into a "Single Inflation" of Consumption Demand.

Prior to the reform, the main problem encountered in China in the area of social demand was investment "starvation," i.e. a "single inflation" of investment demand. After instituting the reform, there occurred the "double inflation" of inflation as well as consumption demand. As the trend is developing, comparing the two, the "single inflation" of consumption demand will become the more serious problem. Especially since 1984, the total amount of staff and workers' salaries and wages throughout the country continuously exceeded increases in production, and it was mainly due to the excessive issues of bonuses, various allowances, and goods, which then in value exceeded basic salaries and wages.

The fast increase of consumption funds had surplus cash purchasing power in the hands of the urban and rural population reach to nearly 550 billion yuan at the end of 1988. In this figure, balances of private savings deposits amounted to 379.8 billion yuan, an increase of almost 18 times compared with the 21.05 billion yuan of 1978. However, the increase in national income is limited, and the share in the increased national income available to each person each day for daily necessities would be only somewhat over 0.20 yuan. A situation of such steep increases in consumption funds is beyond the strength of China's financial resources to support. China is a poor country with a huge population, and the problem of its industrialization will depend for its solution on several generations tightening their belts and working hard to increase private deposits. It is beyond doubt that we must actively utilize foreign capital, but since China's unfavorable foreign trade balance over the years has

reached several billions of U.S. dollars, and the 1990's will, furthermore, be years when repayments will be at their height, the utilization of foreign capital is restricted by the ability to repay the indebtedness. We must, therefore, launch an energetic movement for patriotic deposits at guaranteed value, must give the right direction to consumption and change the composition of consumption, so as to absorb the huge surplus cash purchasing power. At the same time, we must stop the continued inflationary tendency of consumption funds and through a deepening of the enterprise reform, must direct the enthusiasm of staff and workers toward savings in the consumption of raw and semifinished materials, must lower production costs, and must raise product quality and productivity, in order to create more wealth for society. While ensuring more revenue for the state, and allowing the enterprises to retain sufficient production development funds, we must raise the income of staff and workers. If the problem of inflation of consumption funds is solved by effectively restricting it, we shall be able to avoid the mistakes of some East European countries and will achieve success in our economic reform.

III. Unswerving Pursuit of Price Reform, Advancing at a Steady Pace and Observing a Policy of Integrating "Regulation, Decontrolling, and Controlling"

As the Chinese system is one of planned commodity economy, the shift from predominantly direct regulation and control to predominantly indirect regulation and control makes it necessary to straighten out the pricing system and makes price reform essential and necessary. However, since the commodity economy is not yet fully developed in China, market development is not yet on a sound basis, shortages exist of commodities and materials, and low private income leave little capability to endure price rises. On the other hand, since China is also a country of predominantly public ownership, these factors exercise a strong restrictive force on price reform and increase the difficulties of price reform. Price reform in China is a gradual process and demands strong determination, but also maintaining a steady pace. According to the practical experiences of the last few years, price reform must proceed according to a policy of integrating "regulation, decontrols, and controls," this would accord with the national conditions of China. For products that are important for the national economy and the people's livelihood, we must institute planned adjustment of prices. For products which show a basically balanced state of supply and demand, prices may be decontrolled. For high-class durable goods and luxury items, prices may also be decontrolled, but the increases in their prices should benefit the state in the form of special consumption taxes. We must at the same time formulate relevant laws to strengthen supervision and control of commodity prices in the market, strengthen commodity price controls, and must also actively combine development of production with increased supply, to alleviate the supply-demand contradiction, and to achieve the objective of developing the economy and stabilizing commodity prices.

Decentralization, Dual-Track System 40060565 Beijing GAIGE [REFORM] in Chinese No 2, 20 Mar 89 pp 27-29

[Article by Zhao Lukuan 6392 1462 1401: "Appraising the Delegation of Powers and Yielding of Profits; Thoughts on the Reform of the Double-Track System"]

[Text] In its 10 years of reform, China has achieved great successes which have attracted worldwide attention. The ice has been broken, the passage has been opened up, nothing can reverse anymore the onward journey into reform. However, the fact must not be concealed that many errors have been committed in the course of reform, and that great difficulties are being faced. At this critical juncture, an earnest review of experiences and lessons, an affirmation of past achievements, and the correction of past errors, are the basic guarantees for further progress in the reform.

Up to now, we have had no systematic successful experiences in the reform of traditional socialist economic systems. Reforms in the various socialist countries have without exception adopted methods of delegating authority and yielding profits (delegation of some powers and yielding up some profits by the central government to local governments and enterprises). This is very reasonable and also unavoidable at the initial stage of reform. However, we must realize that the effects of delegating power and yielding profits is very limited, and that these measures, if carried out in excess of certain limits, can result in such serious problems as loss of macroeconomic control, a decline in economic efficiency, currency inflation, and unfair distribution.

Delegation of power and yielding profits, as measures by themselves, do not present target models for economic structural reform. At best they merely act as stepping stones toward reform. As short-term emergency measures in the initial stage of reform, delegation of power and yielding profits are acceptable, but they are undesirable as long-term policy. In brief, delegating power and yielding profits are essentially nothing more than improvements within the limits of the old economic system. The 13th CPC National Congress proclaimed "the state regulates the market, and the market guides enterprise" as the target model for the structural reform of the Chinese economy and to be the fundamental substance of the new order of China's commodity economy. This is really an important breakthrough in the theory of economic structural reform in socialist countries. It is an entirely new theory which is radically different from the theory of delegating power and yielding up profits and must under no circumstances be interpreted as being tantamount to delegation of power and yielding up of profits.

People are now arguing about the causes for China's present serious economic situation. I believe that the fundamental reason is that the reform policy, enunciated by the 13th CPC Central Committee, has not been

enforced, and that even less was done to bring about a solution by means of operational measures or specific actions, to realize the above-stated target model for economic structural reform.

Along the same line of thinking as the delegation of power and yielding of profits, there appeared several years ago in newspapers and journals the "double-track system" (its core being the double-track pricing system) as a fashionable concept. Some people even took to calling it "a type of reform with unique Chinese characteristics." Later, the double-track system was put into practice throughout quite an extensive sphere.

As seen by those comrades who had proposed the double-track system, they believed, since the objective of the economic structural reform could be realized only in gradual stages, that the double-track system would therefore be the only possible alternative. I believe this argument appears to be right but is actually wrong. The said viewpoint mixes up the objective of the reform and the measures of reform. Viewed from the angle of the reform objectives, all reform measures must be subordinated to and serve the new operational economic mechanism of "the state regulates the market, and the market guides enterprises." Viewed from the angle of method, it is only possible to approach the stated objectives gradually in separate steps and stages, that is, the new system can only be shaped in separate steps by a complete set of measures that mutually link up together and mutually complement each other. Taking price reform as an example: The objective of the reform is to create a new system of prices which are determined by the markets, i.e. a new system in which commodity prices are determined by the commodity market, interest rates by the capital market, and wages by the labor market. As to methods of reform (operational methods and steps), one may adopt a method of gradually approaching the objective. First one may free commodity markets and their prices (varieties involved are goods in bulk) which have little effect on the livelihood of the population and have comparatively large elasticity in supply and demand. Later again, gradually open up the markets, and their prices, for daily necessities and most important means of production. Opening of the capital and labor markets must not be delayed very long after the other markets have been opened. The opening up of markets for different commodities and key elements of production may be effected at different times, some earlier some later, but it is undesirable for the government to officially permit one and the same commodity to have two prices (market price and plan price). Friedman, a recipient of the Nobel prize in economics, said, "The double-track pricing system is harmful and of no benefit to any country or territory." The double-track system is not only unable to lead to the establishment of the new order of commodity economy, but on the contrary can become a hotbed of speculation and profiteering, especially for official racketeering. This has already been proven by the events of recent years.

The operational mechanism of the product economy system, characterized by an administrative hierarchical control, is radically different from that of the commodity economy system, characterized by market control. The two systems are as incompatible as fire and water. Any attempt to harmonize the two types of mechanisms is bound to end in failure. In recent years, labor productivity in many districts and trades of China has been very low, and economic efficiency has declined. I believe one main reason for this abnormal phenomenon is the double-track system. We have to understand that even though the product economy system is ossified and inefficient, it is in itself a controllable system, which means it has its internal restrictive relations, and it cannot happen that macroeconomic control of it could be lost. The commodity economy system, which is tied to the market, is an organizational system with its own self-regulatory and self-control capability. The government is therefore fully capable of effecting a highly effective macroeconomic control, using the market mechanism (mainly manifested by the internal restrictive relations of the three factors of supply, demand, and prices). It shows that from the angle of macroeconomic control, the double-track system is the most undesirable alternative. This is so because under the conditions of the double-track system, the old highly concentrated hierarchical control methods have lost their effectiveness and a new mechanism suited to the development of the commodity economy can hardly be truly established. As a result, there is failure in both respects. The confusion and wastage in China's economic life of the last few years can mostly be explained by the double-track system.

Finally, we have to clear up a misunderstanding that has been current for a long time in China, namely equating economic structural reform and the use of the market mechanism with the government's delegation of power and yielding of profits and allowing enterprises to fix their own prices for their products, or even to use such slogans as "once decontrolled, it works" and "once contracted, it works," to express the substance of the economic structural reform. In fact, these ideas and methods run counter to common knowledge in modern economics. Under the conditions of the modern commodity economy, it appears outwardly as if the enterprises are determining prices for their own products, but in reality, the enterprises are merely accepting the prices of the market. Should some enterprises over a period of time determine the prices of their own products, it means that these enterprises have a certain economic monopoly, or an administrative monopoly, or a monopoly of both these elements combined, which has resulted in the disruption of the principle of equal competition in the market. Under these circumstances, the government should take some action to protect the market order of equal competition. We have to know that under conditions of modern commodity economy, the government has the function of macroeconomic control, which must not be underrated.

The above-stated misunderstanding makes me think of the historical responsibility which Chinese economists

should assume in the reform. As is known around the world, the vigorous economic development of the Federal Republic of Germany is inseparably linked to the outstanding role played by the economist, professor Erhard. The great undertaking of the Chinese reform calls for the emergence of an Erhard-type Chinese personality. This of course also touches on the reform of the political system, in particular the system of personnel management.

Separation of Enterprises From Government
40060566 Beijing GAIGE [REFORM] in Chinese
No 2, 20 Mar 89 pp 29-31

[Article by He Wei 0149 0251: "Review Our Reform Experience and Implement the Complete Separation of Government and Enterprises"]

[Text] China's 10-year-old restructuring of the economic system has been very successful and has made major breakthroughs in many areas. But there are many experiences that need to be reviewed, and lessons to be learned. Looking back at the last 10 years, practical reform has fallen behind theoretical breakthroughs; political reform has lagged behind economic reform. We have made theoretical breakthroughs and developed new ideas, such as the planned commodity economy and setting standards for the productive forces. In practical reform, however, although we have moved closer to the goal of a commodity economy, we still have a long way to go. To date, we have not turned theories into specific economic programs, and people cannot see the process and procedure as we make the transition from the old to the new economic system. When problems emerge, we often revert to the old system of administrative measures and impose control, and in some areas, we have restored the old methods. People feel that there is no link between theory and practice; theory is not guiding practice. Compared to the restructuring of the economic system, political reform has lagged behind. If the 10-year-old economic reform has attained initial results, political reform has only just begun, and many areas remain untouched. Furthermore, in the transition from the old to the new system, some people have abused their special privileges to reap private gains; graft and bribery, greed and perversion of justice, and other unhealthy tendencies and violation of law are rampant. They obstruct and compromise the process and reputation of economic reform. As the restructuring of the economic system becomes more thorough, the interests of certain departments and individuals will be affected, and the reform process will stall. Today, after we review our reform experience of the past 10 years, the most urgent task will be to work out an all-encompassing political and economic reform scheme and formulate interrelated and coordinated general programs that pertain to the reform and construction in the areas of politics and economics, at the micro and macro levels, in the legislation and enforcement of law, and in supervisory and procuratorial works. We need to establish the reform goal, method, and procedure in each area to give reform a clear sense of

continuity and procedure. Governed by a general scheme, we can then draw up individual reform programs to facilitate implementation.

Before the overall scheme has been worked out, and in order to make the reform process more thorough, we should expand the scope of the separation of government and enterprises. We can change the present superior-subordinate relationship between state and enterprises into a credit loan relationship. Similar to the process which "replaces appropriations with loans," all of the state's investments in enterprises can be replaced by loans, that is, insert the banks between the state and enterprises. All of the government's investments in enterprises are to be converted to bank deposits, and instead of obtaining state investments, enterprises should secure bank loans. After profit and tax are separated, enterprises pay taxes to the government according to regulations; they no longer turn over their profits. The government can earn interest on its deposits but cannot appropriate enterprise profits. Enterprises pay interest on bank loans but need not deliver a share of the profit to the government. In this way, government and enterprises are completely separate, and even if political reform is making little progress, because there is no direct economic relationship between government and enterprises, it will not obstruct the progress of economic reform. This will help us get through the present period of economic difficulties and solve the economic expansion problem.

The CPC Central Committee has adopted a general policy to deal with the present economic situation and has been fairly successful already. But we must realize that these measures only deal with the symptoms and do not effect permanent cure. Some of these measures only restore the old systems; they run counter to the general direction of reform. To curb the economic expansion, we have to find its causes. The basic causes no doubt are the failure to separate government and enterprises and the system of government ownership of publicly-owned productive resources.

First, we must sort out the relationship between the present round of inflation and the restructuring of the economic system. If there is indeed a relationship, we can say only that we have inflation during reform. But we had several rounds of inflation and adjustments even before reform, and so economic reform is not the cause of inflation. Second, we must separate the endogenous and the exogenous causes. This round of inflation has to do with the leaders' impatience for success and errors in their decisions. During the 10 years of reform, not only have we failed to eliminate the root causes of inflation, we have reinforced them in some ways. We not only have failed to make them the target of reform, we have even steered towards them and promoted and reinforced them. Take the local government contract system, for example. The central government's delegation of power and the local government's contract responsibilities at each level makes it impossible to enforce the laws and

prohibitions. It gives rise to regional protectionism—everybody gets his own way; it gives rise to regional separatism—everybody sets up a system of blockade. They inhibit the development of the economy and the regulatory function of the market mechanism; they contradict the purpose of reform. But today, they are looked upon as the direction to turn to and are being reinforced and popularized. We should realize that this kind of local contract system does not expand the role of the market; on the contrary, it only increases the power of the local governments. The central government's delegation of power has not benefited enterprises and has only given the local governments of all levels more power. As long as government and enterprises are mixed together, giving the local governments more power will only diminish the roles of the commodity economy and the market mechanism, nullifying the market's regulatory function. For example, the tax rate and interest rate are important economic levers that regulate the market, but the local contract system preempts their regulatory effect. According to the industrial structure and the availability of raw and processed materials, the central government has stipulated that there should be no new enterprises in some industries, and steep taxes are imposed to curb new investments. For example, the central government has repeatedly prohibited the construction of new cigarette factories and has imposed stiff taxes, but some localities have simply ignored that order, because higher taxes mean higher local profit retention which boosts local revenues. As a result, the regulatory effect of taxes is lost. Interest rates as a lever that regulates the loan funds have lost their effectiveness in the same way. For example, to protect local interests, local governments often force the banks to lend money to new enterprises. If they fail to repay the loans, it is the banks' problem. The governments may also grant tax reduction or exemption, or allow pre-tax loan repayment, or adopt other ways to counter the regulatory effect of interest rates. Under the circumstances, the central government's giving up the right to control capital construction investments has led to bloated investments.

Even though the CPC Central Committee has decided that enterprises should become producers of commodities and managers, under the existing economic management system, the large and mid-sized enterprises are still under the control of government departments. Enterprises have not shown enthusiasm or initiative. Although the existing management system is being reformed, the old economic system basically is intact. Enterprises remain under the various levels of governments. Specifically, one, the financial departments are competing with enterprises for profit; two, the banks are controlling enterprises' use of funds; three, the materials department controls the supply of raw and processed materials and product allocation; four, the labor department supercedes enterprises' right to hire workers; five, the planning department determines the production duties of enterprises; six, the managing department makes personnel arrangements and assigns leading cadres to enterprises. The above six areas make up the three main

elements of enterprise production. They are controlled by various government departments, thus dismembering enterprises' function as decisionmakers in disposing of the key productive elements. Without the permission of one or several departments, enterprises have no authority to gather key productive elements and produce goods, and so low efficiency, wastefulness, and poor economic performance are typical of state-run enterprises. It is impossible for this kind of enterprise to improve its labor productivity; maintaining the existing standard is a hardship already. To enable the national economy to develop at the desired rate, we must rely on new investments and engage in extensive expanded reproduction. For this reason, adding new investments has become the way to guarantee a high rate of economic growth, and bloated investment is the natural consequence.

Under the old economic system, a newly formed enterprise immediately becomes the property of one of the government departments; it becomes a fixture under that department and cannot be moved or transferred. The government manages enterprises in the capacity of owner; it sets the production duties in the capacity of planner, but it is not involved with enterprise operation; it has no right to auction off the enterprises or declare bankruptcy. Once an enterprise is formed, its production direction and product-mix seldom change. Even if it is losing money, it can be subsidized, but seldom will it close down, suspend operation, merge with another enterprise, or convert to another line of business. Inter-department transfer of enterprises is rare. So China's stock of assets does not circulate and the asset structure does not change, and in turn, the allocation of material resources is not optimized and the utility rate of the stock of assets is low. Today, China has 1 trillion yuan worth of assets, one-third of which are idle, and the utility rate of the rest is nowhere near the record rate. Because the stock of assets is buried in the departments, the asset structure has become rigid and the resources are not put to optimal use according to market demand. Because the composition of the stock of assets cannot be adjusted, we have to rely on incremental assets to make up for the inadequate stock of assets and raise the utility rate. But investment in incremental assets is limited and is insignificant relative to the stock of assets; like putting out fire with a cup of water, it is of little use. Even if we can use large quantities of incremental assets to adjust the composition of the stock of assets, it will lead to bloated investment, an overheated economy, and economic disproportion, and we will be forced into a new round of adjustments.

To mobilize the localities to remedy the central government's inadequate investment in capital construction, local governments have been permitted to engage in extrabudgetary investments to keep up the high rate of economic growth. Local government investments of course tend to focus on local economic benefits rather than the overall interest of the country, and so the localities are putting all of the incremental assets into the processing industry, which needs little investment but

generates quick profit. This leaves the energy, transportation, raw and processed materials industries which require huge investment and produce slow results to the central government. In recent years, however, the central government's investments have decreased not only in relative terms but also in absolute terms compared to investments made by local governments. The consequence of this investment system is that a poor mix of incremental assets is added to a poorly structured stock of assets, making the asset composition even worse. To solve this problem, we must increase investments, but the more we invest, the faster the economy expands, and this will lead to economic imbalance, and eventually we will be forced to tighten up and adopt a policy of adjustment to restrict capital construction investments. This may cool the economy but it will lead to stagnation which will force us to lift the restrictions, and once again the economy will expand. China's economic development has followed a four-stage cyclical pattern of expansion—contraction—stagnation—ease of control.

An effective prescription to cure this chronic ailment is not to set up a state-own asset management bureau but to implement the separation of government and enterprises. The government should no longer be the owner of publicly-owned productive resources. Some people have suggested implementing the shareholding system to facilitate the transfer of property to achieve the separation of government and enterprises. This is a possibility. But certain conditions must be met before we can implement the shareholding system; not all enterprises can adopt this system now or even in the future. Some nonprofit enterprises should not adopt the shareholding system. Besides, the shareholding system is but an experiment at this point and has not been promoted nationwide. For these reasons, the transfer of property rights in state-owned enterprises via the shareholding system as the way to adjust the asset composition does not eliminate the expansion and contraction cycles. The "substitution of investment by loans" method, on the other hand, is feasible for all enterprises. After government and enterprises are separated, the asset composition can be adjusted as enterprises try to meet their loan and interest payments. Enterprises unable to pay off their loans can be auctioned off or merged with other enterprises. Meanwhile, the state can recover large sums of investment.

Rectifying Mistakes in Economic Reform
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[Article by Li Jiange 2621 0494 7041: "Some Views on the Present Attempts To Make Adjustments and Rectifications"]

[Text] I. Basic Evaluation of the Economic Situation Since the 3d Plenary Session of the 13th CPC Committee

Since the 3d Plenary Session of the 13th CPC Committee, we have kept inflation somewhat under control; product prices have gradually stabilized; the people's

savings have increased; the purchase of agricultural and sideline products has proceeded faster than in 1987. These indicate that the drastic decisions made by the 3d Plenary Session were absolutely correct. It is obvious that without the courage to salvage the impossible situation then, we would not enjoy the success today. Thus, the general policy of rectification set by the 3d Plenary Session should continue to be enforced with determination.

In 1989, however, all signs indicate that the economic situation is very grim. Immediately after the beginning of 1989, there was a sharp reversal of the usual cash circulation trend (normally, there is a short period after the new year when money is withdrawn from circulation.) The sharp increase in the money supply warrants close attention. Preliminary data indicate that just before the New Year there was a net investment of 35 billion yuan in cash. This poses a tremendous difficulty for the plan which allows only 40 billion yuan in circulation for the whole year. The risk of runs on banks and panic buying in the market is once again increasing.

Today, there are two trends worth noting: one, we still have an overheated economy, and there is excess investment in fixed assets. Statistics show that 200,000 projects are in progress nationwide; they are worth a total of about 1.3 trillion yuan. So far, decisions have been made to suspend only a little more than 10,000 projects; they make up only about 3 percent of the total investment. It is also a widespread phenomenon that while some projects are being cut, others are being completed hastily. Two, we still cannot guarantee the necessary conditions that facilitate production. The supply of energy resources and raw and processed materials has become even more scarce. Today, the reserve of coal for generating electricity is down to 3.5 million tons. The coal reserve in many electrical plants is dwindling, and many generating units have stopped because they have run out of coal.

In analyzing various aspects, there are three possible ways in which the economic situation could develop in the next two years under different policies:

The first scenario is that society's total demand is out of control and the overheated economy continues to expand while the supply of resources gets even more scarce. From the appearance of things, the economy may not "slip" immediately, but as the prices of raw and processed materials continue to increase, after a period of wait-and-see, the people will realize that prices are still surging, and there will be another wave of runs on banks and panic buying, and the economy will collapse.

The second scenario is that the central government fails to find an effective way to adjust the economic structure, and so while demand is being suppressed, effective supply also decreases, and the supply-demand situation in the market deteriorates; local governments run short of money, and enterprise operations run into trouble.

The central government eventually succumbs to the pressure from local governments and enterprises to ease the money supply, and so the tight macroeconomic policy is abandoned midway. The result will be inflation much worse than what we are facing now, and China will be pushed to the abyss of political turmoil.

The third scenario is that the central government adopts tough measures and is determined to reduce society's total demand and adjust the economic structure and keep up the increase in effective supply. After one or two years' hard work, inflation eases, and we will have generated a good economic environment for the Eighth 5-Year Plan.

In striving to realize the third prospect, we will be forced to adopt some necessary administrative measures. We must not regard that as "restoration of the old" or "a step backward." However, we must also realize that these administrative measures are but makeshift measures and are not real solutions to our problems. For example, in order to make this year's prices significantly lower than last year's, we must freeze prices on a broad scale. This will only give our adjustment policies breathing space; however, prices cannot be kept frozen forever, because a price freeze will only aggravate inflation which is now hidden. Meanwhile, because some product prices really cannot be controlled, freezing other prices will only distort the price relations, and the substantial increase in subsidies will add to the government's financial burden. At the end, this kind of price control must be abolished, and inflation will leap to an even higher level.

It looks as though, if we want to turn this grim situation around, we will need much more than the existing adjustment measures. We must reach a common understanding and work much harder. Besides continuing to tighten the economy with the same intensity, we should review our reform experience of the past few years and strive to find a new approach.

II. Reviewing and Learning From the Reform Experience of the Last 10 Years Is the Key to Successful Rectifications

Today, a vast majority of our comrades feel that to cool off the economy and check inflation, we must control society's total demand and adjust the economic structure. But previous rounds of contraction after each period of expansion in the last 10 years were, without exception, abandoned because of the dilemma we were in. When the economy overheats, we have no choice but to adopt a tight policy, but tightening will not produce the anticipated results. When we bring out the tight policy, often supply is the first to be reduced, before the excess demand is effectively controlled, and before the structure is adjusted. Under pressure, we are forced to lift the control over demand, and since supply has not increased, demand created by increased input soars and the economy continues to grow in an unhealthy way because of the deteriorated economic structure. Conflicts, latent and exposed,

become more acute. To escape this vicious cycle of expansion—contraction—easing—renewed expansion, we must reexamine the path we took in the last 10 years and the system we have today. We must look for the causes buried in the economic system. We should keep and further develop those aspects which are correct and rectify and improve those which are erroneous.

The overall direction of the 10 years of reform is correct. We made no major mistakes, but we made many minor ones. Primarily, they are mistakes in the choice of reform and development strategies and tactics. We must not overlook minor mistakes which can jeopardize our reform, because if we do not rectify little mistakes, they can become big mistakes. We want to review our experience and correct the mistakes now, because we want the reform to be more thorough. We must admit that we have missed several opportunities to rethink and review our experience and to start over again. A year ago, in 1985 and 1986, leading comrades in the central government made arrangements for the relevant departments to conduct a comprehensive review of the economic tasks under the Sixth 5-Year Plan and the reform and development in the 8 years since the 3d Plenary Session of the 11th CPC Central Committee. Economic theorists and practitioners had prepared many articles and made in-depth analyses and honest evaluations of the economic policies and reform measures. But for some understandable reasons, and especially because the many difficulties in the economy still seemed mild and latent, many people did not realize, nor were they willing to admit, that we were in danger. In 1988, the economic situation took a drastic turn for the worse; the grim reality forced many Chinese to painfully admit for the first time that if we fail to engage in a rational and objective review of this decade-old reform, if we continue to bump around, the future will be too uncertain.

We suggest that as we sum up everything, briefly, the following eight areas warrant our careful study:

One, in the last few years, we have adopted a developmental strategy to pursue quantitative growth. Although we tried to pay attention to improving our economic efficiency as well, we have not applied ourselves in practice. Because of the tremendous population pressure, it is extremely difficult indeed to overcome the urge to pursue quantitative growth. But both theory and practice prove that without improving economic efficiency and increasing effective accumulation, living off our past gains and spending everything on consumption and diverting most of the excess rural labor to the nonagricultural sectors cannot sustain us forever. In particular, raising the people's consumption level too much and too soon to stimulate their enthusiasm for work at the early stage of reform is not something the economy can sustain.

Two, at one time, in order to support a super-high rate of economic growth, we put our hopes in the money supply to give us impetus. Today, we still have the erroneous concept that when society runs out of resources due to

excess demand, from the standpoint of one locality or one enterprise, as long as the banks supply enough money, one can still buy the goods and materials one needs in the market; and so everybody asks the bank to issue more money. This creates intense pressure to ease the money supply. Little do these people know that when they get that money, it will only force the price level to rise to a higher level, and each person can buy even less goods and materials.

Three, as a part of our reform tactic, we have intentionally or unintentionally given special or tacit permission to some behaviors that "break the rules" or "exceed the bounds" as a way to facilitate the reform. Several years ago, we were told that "it is okay to make mistakes during reform, but it is not okay not to reform" and "don't sit around waiting for instructions from above." Today's "red light" theory is a consequence we should have expected. The prestige of the central government and the various leading organs has sunk to a historic low point—this is the main reason why today's general rectification policy has not been carried out successfully.

Four, the history of economic development of countries all over the world tells us that the power of macroeconomic adjustment and control should not be decentralized. Right from the beginning, our 10-year reform unwittingly has followed the same road China had gone down several times before in previous reforms; that is, the central government broke down and apportioned the administrative management rights among the local departments of all levels. With the division of administrative authorities, the resulting reckless installation of experimental points, the redundant constructions, the market separatism, and the regional blockade and check points became rampant. This has diminished the central government's capacity to exercise macroeconomic control and has caused the large cities where the manufacturing industry concentrates to shrink and wither away. On the other hand, because society's overall economic efficiency has declined, and because the underdeveloped regions have not used their own strength properly, they too have incurred losses. This is the main reason why China's economy is in jeopardy.

Five, we sacrificed the state's revenues when we delegated authority and yielded profit to enterprises; but on the one hand, this has not made enterprises better equipped to accumulate and finance their own development; instead it has encouraged them to distribute the earnings and indulge in wasteful and extravagant practices. On the other hand, agencies which used to be funded by the government have fallen on hard times and have to find ways to make a living. Most seriously affected are educational, scientific and technological, and cultural undertakings, and even the army and the police are forced to find ways to make money to support themselves, and the law-enforcement departments are plagued by corrupt and illegal practices. This is indeed worrisome.

Six, the allocation of the national income has a counter-modernization tendency. As mentioned above, because

the government has not appropriated sufficient funds, the intellectuals' real and relative income have declined, and therefore few are interested in scientific research jobs and teaching jobs. Meanwhile, profiteers who dare to break the law are making a fortune. Social value which deems "education is useless" and "knowledge has depreciated in value" undermines the educational undertakings. The university students are full of discontent. Today, consumers who generally are not well educated are the ones who can afford the cultural products, and so martial arts, romance, and other crude and unsophisticated novels and movies have flooded the market. These no doubt are the symptoms of a sick society. All these will delay China's modernization.

Seven, we have adopted a "double-track" pricing system as an interim measure, and despite historic reasons for doing so, the prolonged maintenance of this system has in fact made the poor allocation of resources even worse. The development of many township enterprises and privately run enterprises, even though they compete with the major industries for raw and processed materials and energy resources, has sustained industrial growth in recent years; however, this kind of predatory use of material resources has become a major concern in our future economic development.

Eight, the one-sided pursuit of "high volume imports and exports" which grew out of our grand international circulation policy and the foreign trade system which complements that policy has drained our national income. China's improper pricing system has led to an improper import-export composition. In addition, because of the internal strife between regions and between enterprises, and because the "high volume imports and exports" has turned the international market prices against China as we try to make changes, we have incurred huge foreign trade losses in recent years.

The above is but an incomplete summation. From different perspectives, we should be able to learn even more from our experiences and lessons of the past 10 years. Only by continuing to conduct this kind of review diligently can we succeed in our present macroeconomic control and rectifications.

III. Rectification and Adjustment Efforts Should Focus on Correcting the Mistakes Made During Reform

Over the last few months, the series of rectification and adjustment measures promulgated by the State Council has obtained some initial results. We should continue this process with firm determination. We suggest that rectification and adjustment should shift from the present stopgap measures, which only cure the symptoms, to radical measures which would effect a permanent cure. Specifically, the emphasis of rectification is not to try to cool off the overheated economy; rather, upon careful review, we should focus on correcting the mistakes made during reform.

There are two types of mistakes. The first type is strategic error, like the eight areas analyzed earlier and

other similar mistakes. The second type is error in timing; for instance, the operation of specialized banks as enterprises and certain premature phenomena in the financial market. We must differentiate the situations and correct these mistakes.

Today, people are also making a mistake in categorizing the different rectification measures sweepingly and simplistically as either reform or retreat. This is unscientific. For example, in imposing macroeconomic control in any country, the choice of loose or tight policy often depends on the situation; they are adopted alternately. Some people simply equate loosening to reform and tightening to a step backward. This classification only confuses the issue and makes things worse.

Another kind of argument which obstructs the review process is the separation of the Chinese people into reformers and bystanders. This is not very serious. In China, nobody is indifferent to reform; everybody is concerned about the fate of China's reform. Nobody can proclaim himself a reformer; nobody can use the reform label to ward off criticism. Nor can one label others as bystanders and rob them of their right to review the reform experience.

Recently, some comrades have felt that their hope for the future of reform has been dashed, and they have advocated

the private-ownership system as China's salvation. They suggest that all China needs is the private-ownership system; that all this rethinking about reform is unnecessary. The 13th Party Congress has clarified that the private-ownership system is permissible and may be developed to some extent, but replacing the public-ownership system with the private-ownership system as the main system is not a simple matter. Worldwide, those economies which embrace the public-ownership system indeed are facing drastic reforms, but countries with the private-ownership system too are suffering the pains of war, corruption, and poverty. We cannot suddenly convert from the worship of utopian socialism to the worship of the private ownership system. This is not in keeping with the majority of the Chinese people's aspirations, nor is it in line with the mainstream of world development.

Thus, to make proper rectifications and adjustments, we are faced with many arduous and complicated tasks as we try to clarify the situation, seek unity in thinking, draw up careful plans, and put our plans into practice. For this reason, we suggest extending the economic adjustment period. We can consider working out a 3-year adjustment plan before we begin drawing up the Eighth 5-Year Plan so that we have a clear idea about the goal, tasks, measures, and procedure of the entire adjustment process and become more aware of the rectification and adjustment process.