

THE IMPACT OF ECONOMIC REFORMS ON POST-1978 URBAN  
CHINA: A CASE STUDY OF THE RESTRUCTURING PROCESS OF  
THE STATE-OWNED ENTERPRISES

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MASTER OF PHILOSOPHY

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**CERTIFICATE**

This dissertation entitled "THE IMPACT OF ECONOMIC REFORMS ON POST-1978 URBAN CHINA: A CASE STUDY OF THE RESTRUCTURING PROCESS OF THE STATE-OWNED ENTERPRISES" is submitted by ARAVIND BALAJI YELERY in partial fulfillment of six credits for the degree of MASTER OF PHILOSOPHY of this University. This dissertation is his original work according to the best of our knowledge and has not been submitted for any other degree of this University or any other University. We recommend that this dissertation be placed before the examiners for evaluation

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## Abbreviations

ACFTU	All China Federation Of Trade Union
ADB	Asian Development Bank
CASS	Chinese Academy for Social Sciences
CCP	Chinese Communist Party
CMEA	Council for Mutual Economic Assistance
CRS	Contract Responsibility System
CTS	Computerized Tomographic Scanners
EBRD	European Bank for Reconstruction and Development
FDI	Foreign Direct Investment
GDI	Gross Domestic Investment
GDP	Gross Domestic Product
GLFM	Great Leap Forward Movement
HCRS	Household Contract Responsibility System
IMF	International Monetary Fund
JSC	Joint Stock Company
JLSC	Joint Limited Stock Company
LLC	Limited Liability Company
NBS	National Bureau of Statistics
NPC	National People's Congress
OECD	Organization for Economic Co-operation and Development
PLA	People's Liberation Army
PRC	People's Republic of China
SCRES	State Commission for the Restructuring of the Economic System
SETC	State Economic and Trade Commission
SEZ	Special Economic Zone
SOE	State-owned Enterprise
SSB	State Statistical Bureau



TVE

Township and Village Enterprise

WTO

World Trade Organization

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What soon grows old? Gratitude

- Aristotle

*The Impact of Economic Reforms on Post-1978 Urban China: A Case Study of the Restructuring Process of the State-owned Enterprises*, in a very real sense represents the result of events set in motion two and a half years ago when for the first time I read a scholarly work on China's economic transformation done by Elizabeth Economy. Until then I had read only few classical commentaries on China. The quest to understand China's all round transformation brought me to New Delhi. In JNU, I was fortunate to have the opportunity to learn so much from Dr. G.P. Deshpande, Dr. Madhu Bhalla, Dr. Alka Achrya, and Dr. D. Varaprasad Sekhar.

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## Preface

The dramatic social, economic, and cultural changes that have been taking place in China over the past fifty years have been attracted immense attention from all over the world. China has seen many shifts in its recent history. The old order under Mao, maintained by stringent state control over the economy and everyday life has gradually but decisively weakened by the market forces, which were openly invited by the new revisionist line of political leaders. The shift to 'socialist modernization' brought China away from a centrally administered economy to a more decentralized system that allowed greater local autonomy. By this China aimed to achieve the Socialist Market Economy with Chinese characteristics, which means free market within a communist society. The Market, instead of state became the major pricing mechanism. As a result of these reforms, the Chinese economy has become one of the fastest growing economies in the world with per capita income more than quadrupling since the onset of economic reforms in 1978. China has risen from the state of poverty to be an economic giant:

In this scenario, the role of industries has been crucial and state-owned enterprises held a central position. As part of increasing economic development, the important step to restructure the State-Owned Enterprises (SOEs) was taken up. The restructuring process aimed at making SOEs more efficient and at the same time to improve their performance. In the intensified process of reforming the SOE, the Chinese state started gradually withdrawing its financial support

and relaxing its control, and vitalizing them through structural changes (reorganization, association, merger, leasing, contract operation, joint stock partnership, outright sale). The efforts proved helpful to increase the efficiency of the SOEs but at the same time those proved harmful for the urban society, especially for the workers. Due to the introduction of reforms and the end of economic equality, the class structure of Chinese society has undergone a profound transformation. The list of effects also includes rising income disparity, regional disparity, inflation, housing inequality, erosion of *Danwei* system, unemployment, and social instability. The lay offs, as a part of the restructuring process has given rise to spontaneous worker protests. The reforms process poorly affecting the sociology of development. The worker, who is the central figure of communist ideology, is getting betrayed. Along with the workers, common Chinese are also not fully satisfied with the economic development.

For the ruling party, such incidents present one of its biggest problems. China's shift to market socialist economy has not yet completed. In future the increased social unrest may undermine the rule of Chinese Communist Party (CCP). These kinds of agitations are new and at the same time widespread. This makes it very difficult to neglect workers or to take strong action against them, as they had done with Falung Gong.

The present study is based on the following hypothesis that the negative outcome of the economic transformation can create severe problems for the political establishment in China, if not handled properly. Moreover, the post-Mao institutional reforms in SOEs transformed them from political institutions to depoliticised economic entities. In this process, the multifunctional tasks of *Danwei* system came under threat, and as a result of this, in future, there may be a widespread social crisis in urban China.

This study seeks to address the following questions and objectives:

- ✓ How did the transformation take place in socialist societies? And how many of them proved successful?
- ✓ What has been the nature of economic progress made since the establishment of PRC in 1949?
- ✓ What were some of the reasons for introducing economic reforms in 1978?
- ✓ How far the restructuring process of SOEs was an inevitable part of the economic reform and what were the measures taken?
- ✓ What has been the role of the state machinery in introducing economic reforms?
- ✓ What are the results of micro-level reforms on urban China's population?
- ✓ What is the nature of social instability and unrest in urban China?
- ✓ What is the political impact of the crisis?

For a more qualitative analysis of the subject, the methodology adopted in this study is analytical in nature and backed by a case study. The study is based on the review of materials relating to economic reforms, restructuring of SOEs, social change and unrest. This study makes use of both primary and secondary sources. The primary sources include government documents and publications, the publication and resolution of the United Nations, World Bank and other official sources. The secondary resources will include books and articles published in various research journals and periodicals as well as reports. In particular, the thrust of the case study is on the unfolding implications of economic reforms on China's urban society.

The study has five chapters. Chapter First is the theoretical chapter, which focuses on various theoretical aspects of the transformation. This chapter concentrates on the experiment of economic reforms in socialist countries. It is a comparative study of the transition taken place in these countries (Russia, Bulgaria, Czechoslovakia, Hungary, Poland, Romania) vis-à-vis to China's experiment.

Chapter Two gives an overview of economic reforms in Deng's China. In this chapter, the reform programme, its origin, content, accomplishments, and implications are discussed in detail. The chief concern is to know the intentions of the reformers and the effectiveness of their programme.

Chapter Three turns to a discussion about the Restructuring of the State-owned Enterprises. In the process of revising the Maoist economic structure, it

became inevitable to restructure the SOEs. The chapter reviews China's experience in introducing various measures. The chapter analyses the transition of SOEs from the 'backbone of the economy' to 'epicenter of economic imbalance'. As a remedy to the problem, Chinese government introduced reforms; the reforms took place periodically, each time after revising earlier reform measures. The chapter gives an account of each reform efforts-chronologically and methodologically.

Chapter Four analyses the effects of economic reforms on the broader level and the impact of restructuring of SOEs in particular, on urban China. The perils of the reform process are causing social instability, which is the major thrust of this chapter.

The last chapter highlights the conclusions that the study has arrived at.



## **Chapter 1**

# **Introduction: A Comparative Analysis of China and the other Socialist Economies**

## Chapter 1

### Introduction: A Comparative Analysis of China and the other Socialist Economies

#### 1.1. Introduction

In December 1978, the third party plenum repudiated both the leftist<sup>1</sup> and the soviet model of development for rapid expansion of the China's economy and began a radical reform process that was named as 'shift to socialist modernization'. After the third party plenum in December 1978, China began moving away from a centrally administered economy to a more decentralized system that allowed greater local autonomy. By introducing reforms, China aimed to achieve the 'Socialism with Chinese characteristics'.<sup>2</sup> As a result, China has recorded exponential rates of growth in the last two decades of the twentieth century averaging more than 10 per cent.

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<sup>1</sup> Here the Leftist way of development means the heavy emphasis on the radical ideological thinking.

<sup>2</sup> The 12th CPC Congress was held in September 1982 amid high expectations of economic reforms. In terms of ideology and its discursive framework, the 12th Congress was noted for themes viz. 'Socialist Spiritual Civilization' and Deng's concept of 'Socialism with Chinese characteristics'. At this Congress Deng put the most vital theme for future Chinese economy. One can say that this was the most important ideological concept in his political career. About building socialism with Chinese characteristics he stated, "In carrying out our modernization programme we must proceed from Chinese realities ...We must integrate the universal truth of Marxism with the characteristics of China, blaze a path of our own and build a socialism with Chinese characteristics."

(Deng Xiaoping, "Opening speech at the Twelfth National Congress of the Communist Party of China", September 1, 1982, in Zhang, Wei-Wei, *Ideology and Economic Reform under Deng Xiaoping 1978-1993*, (London, 1996) p. 49.)

Deng's effort was to find out solution to the problem created by the socialism. The path was a result of Deng's exploration. And this shows that how Deng was trying to deviate himself from the moderate Leninist approach. According to Zhang, Deng's discourse on 'Socialism with Chinese characteristics' was to highlight the Chinese national and ideological identity and independence from both the Soviet Communist Model and the Western Capitalist Model.

After the two decades of reforms, the success of China's economic policies has been widely recognized. Compared to the other developed and developing countries all over the world China's GDP growth is outstanding. In the 19<sup>th</sup> century and in the early 20<sup>th</sup> century the GDP growth was at a pitiable position, which later after the war years it tried to reach the level of the GDP of the other countries. The process of marketization has not only given the economic sphere a new shape but also led to remarkable changes in the Chinese society. Urbanization, more literary freedom, expanded education, media exposure and more frequent contacts with the West have brought in radical changes in the social structure and unquestionably given post-Mao society a new shape. But still, the challenges Beijing faces are vast. The challenge of increasing unemployment, rising income disparity, wide spread social unrest created due to the laid off workers etc. As Premier Zhu Rongji, during his speech in March 1999 National People's Congress (NPC) said, 'economic order is somewhat in disarray', 'financial discipline is lax', and 'demand in the market is feeble'.<sup>3</sup> Chinese state failed to harmonize economic and social development and to ensure that the benefits of economic progress reach the population as a whole. As World Bank argued in its recent report entitled *China 2020: Sharing Rising Incomes* that "People with schooling mobility and good land have been able to take advantage of the new market opportunities, helping to spur the growth." But government policies, or their absence are heightening inequalities; social

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<sup>3</sup> Susan V. Lawrence, "Reality-Check: At least Premier Zhu isn't hiding China's problems", *Far Eastern Economic Review* (Hong Kong), 18 March 1999, p. 26.

policies favour the coast. Access to education, health care and employment opportunities remain unequal or have become more so.”<sup>4</sup> During the step to open the economy for the market, State-owned Enterprises (SOEs) were targeted mainly. The important step to accelerate the pace of reforms was to restructure the SOEs. Judged by their performance, the 305,000 SOEs were extremely successful in producing vast quantities of basic commodities such as iron, steel, coal and cotton of which China became the World’s biggest producer. This was achieved alongside a number of problems such as quality and cost. In addition, the state sector was not adequately equipped in responding to market needs. One of the most pressing problems faced by the current leadership in China was the enormous burden on the national budget created by increasingly inefficient SOEs. The main banks were saddled with ‘non-performing loans’ and were technically bankrupt. On the other hand, the ‘social security’ burden started increasing on the SOEs.<sup>5</sup> The aim of the restructuring process, to make SOEs more efficient and improve their performance to face the upcoming challenges, helped a lot. In the intensified process of reforming of SOEs, the state would gradually withdraw and relax control, vitalize them through reorganization, association, merger, leasing, contract operation, joint-stock partnership and outright sale. As a part of this, Zhu Rongji, at the fifteenth NPC in March 1998, announced a renewed effort to make the SOEs competitive, to configure the

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<sup>4</sup> World Bank, *China 2020: Sharing Rising Incomes* (New York, 1997), p. ix.

<sup>5</sup> Here social security means, subsidized housing, medical care for employees, along with ‘cradle to grave’ policy of providing housing to retired employees until death and the policy of providing retirees the same level of medical care that current workers receive.

banking system and to streamline the government bureaucracy by eliminating 50 per cent of work force.<sup>6</sup>

The failure in the open market competition and the financial problems caused the state to initiate the restructuring process of SOEs, as a result the issues of social welfare and development became more complex. The lay offs, a part of the restructuring process has given rise to mass of unemployed people. With the end of the Iron Rice Bowl, the working class has been hit harder.<sup>7</sup> The situation became worse when more than 80 million or more are affected by the restructuring of the SOEs.<sup>8</sup> Since the early 1990s, more than half are estimated to have lost their jobs, which have given rise to spontaneous worker protests. The efforts are taken to pacify the growing intensity of public anger by encouraging them to move to the countryside. Some cities, including Beijing and also those in the hard hit north-east have begun to encourage redundant workers and coal-miners go back to farming, offering incentives such as interest-free loans, three year tax exemption and free farm equipment to those who switch to full time farming. Some have been offered posts as village officials, as well as membership of the communist party and full retentions of the benefits that they

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<sup>6</sup> Erik Eckholm, "New China Leader Promises Reform for Every Sector", *New York Times* (New York), 20 March 1998, p. 2.

<sup>7</sup> Symbols and slogans, always important in Chinese society, continue to provide a litany of the communist party's ideological objectives and accomplishments. Rice has been China's staple food for thousands of years, and the most important symbol of the party's economic policies has been an unbreakable iron, which stood for the cradle to grave security offered to all citizens.

<sup>8</sup> Jiang Xueqin, "Fighting to Organize", *Far Eastern Economic Review* (Hong Kong), 6 September 2001, p.72.

used to hold as urban workers<sup>9</sup> but these efforts can prove less to guarantee stability while implementing reforms.

Even Chinese leaders accept the challenge knocking on the door. The efforts to restructure the economy mean accepting the need to allow economic institutions to follow independent path of self-assessment and their market behaviour.

China is not the only socialist country to start this kind of transformation in the socialist economy. In the East Europe and former Soviet Russia the efforts were made to transform the economy, though the way of transformation was different from that the Chinese. Before moving further it is very necessary to discuss the idea or the situation, which made the transformation inevitable. How and why the transformation became indispensable for the Chinese government.

## **1.2. Logic and Evolution of Economic Transformation in Socialist societies**

In December 1978, revolutionary changes in the economic field of China started taking place. This was the first time when in China, the idea of economic transformation reached its peak and the process of socialist modernization began. Since the end of the cold war the political and the economic 'strength' of the socialist countries started declining. Socialist economy as a theory<sup>10</sup> came in

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<sup>9</sup> Jasper Becker, "The good news about being fired", quoted by Jasper Becker in *The Chinese* (New York, 2000), p.104.

<sup>10</sup> The socialist economy propounds abolishing exploitation through social ownership; socialist economic planning enables the anarchy of production to be replaced by conscious and collective social control of the economy. In this system a single set of coordinated decisions over the use of society's productive resources as a whole, which necessarily precludes ownership and fragmented decision-making.

to crisis. The practical solution to resolve the stagnated development started taking place in socialist countries. Earlier to this change, Soviet Russia was successfully preaching the importance of Command economy all over the world. The Soviet system, which after the formation of the Council for Mutual Economic Assistance (CMEA) in 1949 incorporated the countries in Eastern Europe as well as the Soviet Union itself, was “based on the proposition that social gain is maximized by the state commands”<sup>11</sup>, whereas, the western society’s economies were “fashioned on the proposition that as individuals pursue their private gain, the benefits for the country will exceed its costs, yielding a social gain.”<sup>12</sup> The governments of the socialist states accepted “an economic and political system based on collective or state ownership of the ‘means of production’ and ‘distribution’.”<sup>13</sup> These governments did not allow prices to play a role in encouraging production and regulating the distribution of goods and services.

The denial of price factor, production efficiency and technological innovations hampered the modernization efforts of command economies. Decades of centralized state planning had been economically disastrous. “The economic problems produced by the command economy were, a declining rate of growth in productivity; a shifting of managerial initiative and worker enthusiasm at the production unit level; an economic sector imbalance

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<sup>11</sup> Charles W. Kegley (Jr.) and Eugene R. Wittkopf, *World Politics: Trend and Transformation* (New York, 1993), p.252.

<sup>12</sup> Raymond Vernon, “Fragile Foundation of East-West Trade”, *Foreign Affairs* (New York), vol. 57, summer 1979, cited in Kegley, n. 11, p. 252.

(specifically in favour of heavy industry and at the expense of light industry); and failure to meet consumer demand.”<sup>14</sup> To avoid getting permanently renounced as a developing country, and to halt the erosion of living standards apparent for some years, leaders in the Soviet Union and elsewhere in Eastern Europe embarked on a bold path to transform moribund economies into market systems and to end the isolation of the command economies from the western world by seeking integration into the capitalist World economy.

The reforms and economic transformation in these socialist societies has been taking place under the banner of Market Socialism. As mentioned earlier the ideas of market socialism had been around much earlier, it was not until the 1960s that they became the basis for practical reform programmes in Eastern Europe, notably the introduction of the New Economic Mechanism in Hungary beginning in 1968. Market socialism, “a pragmatic reform concept that has increasingly compromised the Marxian dream of a non-market, non-state economy or its Stalinist mutant of the centrally planned state economy.”<sup>15</sup> Market Socialism for socialist states has also meant opening their economies to the west, seeking foreign capital and technology by inviting foreign investment and participating in international financial institutions like the International Monetary Fund, World Bank and World Trade Organization in the present context. “The socialist countries attempting market reforms have generally

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<sup>13</sup> Gordon Marshall (ed.), *Oxford Dictionary of Sociology* (New York, 1998), pp. 622-23.

<sup>14</sup> Peter Van Ness (ed.), *Market in Socialist Societies: Comparing China and Hungary* (Boulder, 1989), p. 9.



accepted Western notion of 'interdependence' and 'international division of labour' and are attempting to design their own market socialist growth strategies in order to benefit from greater participation in the World Market Economy."<sup>16</sup> Merely by accepting the new way doesn't assure the success, the way ahead was promising as well as discouraging. "The transition promises to be difficult, and success is by no means assured"<sup>17</sup> Transforming a centrally planned economy into a market economy requires complex and unprecedented reforms. And that is why challenging to reform the economy. In the socialist societies the so-called hasty numerical development was achieved at the cost of ground realities.<sup>18</sup> "The Soviet-type command economy and a Stalinist political system that shuts its citizens off from regular contact with the outside world, diminish the capacity of socialist countries to compete, and the result is a relative decline in performance as measured by world standards."<sup>19</sup>

The market socialism in the socialist countries was implemented in two major ways, in a rapid 'Big Bang' manner and 'Gradualist' way. These two ways were gradually developed and were not the part of original theory of market socialism. The earlier discussed Sachs model of development was widely expected by most of the socialist societies to achieve rapid economic growth.

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<sup>15</sup> Janos Matyas Kovacs, and Martori Tardos (eds.), *Reform and Transformation in Eastern Europe: Soviet type economies on the threshold of change* (London, 1992), p. XI.

<sup>16</sup> Ness, n. 14, p. 13.

<sup>17</sup> Susan M. Collins, and Rodrik Dani, *Eastern Europe and The Soviet Economy in the World Economy* (Washington D.C., 1991), p. 2.

<sup>18</sup> Here the term 'numerical development' has been used to stress the fake importance to data and numericals, while assessing country's economy. Sometimes the reality varies from the state projected and doctored data.

<sup>19</sup> Ness, n. 14, p. 13

This well-known American economic Professor after serving his time in Bolivia arrived in Central and Eastern Europe with panache of Francisco Pizarro in order to surprise the surgical operation they considered necessary for economic revival.<sup>20</sup> The contribution of Jeffery Sachs is very worthy in understanding the Shock Therapy. Sachs is widely credited with founding a new discipline, 'The economic theory of transition'. Sachs' policy has had various names: 'shock treatment', 'radical economic reform', 'big bang', and 'shock therapy'. Sachs formulated his model to solve one big problem: how should the entire ex-communist region of Eastern Europe and the USSR to be reorganized in order to achieve, in Sachs words, 'a recovery of human freedom and a democratically based rise in living standards.'<sup>21</sup> In the Soviet Union and Eastern Europe, Ideology based economic system failed as steadily as it tried to rise. Overall the decade of the 1980s was full of dramatic incidents, which were already marked as the historical events. The political and economic dynamic change in the Central and Eastern Europe and the former Soviet Union created a new historical conjuncture in which the very future of the socialist project has been called in to question.

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<sup>20</sup> Laslo Andor and Martin Summers, *Market Failure: A Guide to the East European Economic Miracle* (London, 1998), p. 22.

<sup>21</sup> Jeffery Sachs, "Understanding Shock Therapy" cited in Peter Gowan, "Neo-Liberal Theory and Practice for Eastern Europe" in *New Left Review* (London), no. 213, September-October 1995, pp. 1-60.

Sachs has given some condition for the success of the new policy which includes:

"(1) Open international trade; (2) currency convertibility; (3) private ownership as the main engine of economic growth; (4) cooperate ownership as the dominant organizational form for large enterprises; (5) openness to foreign investment; and (6) membership of key international economic institutions, including the IMF, the World Bank, and the GATT..." (Source: *ibid.*)

The economies of these countries stagnated and their re-entry in the World economy proceeded at a snail's pace. Whereas in China, Communist party did not fall, and the economy has been transformed not with a big bang but by step-by-step process that is Gradual economic development. Its economy grew faster and it has been reintegrated itself in to the World economy. China and Hungary have made important gains by introducing market reforms and opening their societies to foreign contacts, and now the Soviet Russia in following their example.

### **1.3. Rise of the Planned Commodity Economy in China**

The transformation which is going on in China is the next episode of the change occurred in socialist societies. Speaking about the ongoing transformation in China, William Overholt points out, "What makes China's success so striking is the contrast to the economic failures of European countries that abandoned communism...many knowledgeable Chinese familiar with the recent developments in Eastern Europe are thankful that they live in China. They may not like their communist party, but after having seen the results of chaos in their nation over the last tow hundred years, they are prepared to accept a regime that provides order and allow them to escape poverty and begin to enjoy the benefits of modern industry."<sup>22</sup> The Chinese had understood the importance of the market and that's why their move towards the market started with a conscious step. If a country decides to transform its economy, it can be just

because of the primitive, underdeveloped economic development and that's why in the most of the cases the market becomes the centre of the transforming economy. The market must play a significant role in the transition process to increase economic efficiency, realize country's inherent potential for material prosperity, check bureaucratic power and extend the scope for initiative and responsibility among the immediate producers. The manner in which the market values get introduced in the system is a different matter because the redefining and the re-suiting of the market are always expected and it differs from each other. The same thing happened in China, in the initial stage the Chinese leaders planned to merge market and the planned economy in to a 'planned commodity economy' by introducing elements of the market.<sup>23</sup> It is clearly visible that the Chinese leaders adopted the market values maintaining the planned economic structure or in other words the bureaucratic 'socialist' economy.<sup>24</sup> On this World Bank has argued that "to be efficient, enterprises must be motivated to improve their economic performance; they must have some freedom for manoeuvre; they must be faced with economically rational prices; and they must be subjected to competition ... In addition, the state must retain the ability to direct the overall pace and pattern of development. The essence- and the difficulty – of a successful and comprehensive reform thus lies not only in bringing together the

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<sup>22</sup> William H. Overholt, *China: The Next Superpower* (London, 1993), p. 2.

<sup>23</sup> The elements of the market economy can be broadly described as follows, supply / demand pricing, competition, specialization, economic incentives, rewards for performance, the threat of unemployment and bankruptcy for failure to reform.

<sup>24</sup> As earlier discussed at various places the term has been understood as majority state ownership and the predominance of centralized bureaucratic planning.

several elements of market regulation, but also in combining them with an appropriately modified system of planning.”<sup>25</sup>

Since the system was deeply accustomed to the technical bureaucratic procedures and structured according to the bureaucratic manner<sup>26</sup> Chinese leaders found difficult to follow the ‘pre-planned manner’ of economic development. This administrative problem of policy formulation and implementation of policy made leaders to adopt a gradual implementation of progressively deeper, even more radical market reforms within the overall framework of the state-owned, state-planned economy<sup>27</sup> which evolved through three different stages, first, the devolution of authority to the enterprise managers and the introduction of state / enterprise sharing.<sup>28</sup> The connection between the flexible production decision and the profit was set. Secondly, “the gradual freeing of prices and state control over resource allocation, so that newly empowered managers could respond to market demand and maximize the cost / price ratio (this second step began with the institution of free market prices for sales of over-plan output in the early 1980s).”<sup>29</sup> Thirdly, “the imposition of ‘hard budget constraint’, that is capitalist-like sanctions of bankruptcy and unemployment, to force procedures to respond appropriately to market signals

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<sup>25</sup> World Bank, *China: Long Term Development Issues and Options* (Baltimore: World Bank Publication, 1985), p. 8.

<sup>26</sup> Richard Smith, “The Chinese Road to Capitalism”, in *New Left Review* (London), no. 199, May-June 1993, pp. 55-99.

<sup>27</sup> *ibid.*

<sup>28</sup> *ibid.*

<sup>29</sup> *ibid.*

on pain of failure.”<sup>30</sup> This was probably the step to accept market as far as the efficiency of enterprises was concerned. It opened the enterprises to the market system. The state sponsored economic reforms in China are doing well with a planning still continues in some of the state enterprises.

#### **1.4. Enterprise Reform in East European Countries and China: A Comparative Analysis**

In developing countries the economic role of government grew dramatically in the second half of the Twentieth century, after the end colonialism and in pursuit of such development goals as industrialization and social equity. In many of these countries the state was striving to mobilize resources and direct them toward rapid economic growth, rather than just to stabilize the economy, as in the most developed countries. Until the 1980s the pattern of state-dominated development, which included centralized planning and state control of the economy, was widely followed. The budgets of the smaller developing states are proportionately very smaller. Developed countries because of the large budget could spend more on social services. In developing countries much less government spending is possible for social services and much more is used to subsidized enterprise’ processing goods and processed goods. According to the World Bank data during 1986 and 1991 the poor countries spent 14 percent share of their GDP on SOEs, whereas, the share was 28 percent as far as the Gross Domestic Investment (GDI) was concerned.

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<sup>30</sup> *ibid.*

During the same time the wave of western thinkers brought the idea of privatization in the region. This was the main reason for the advancement of the private sector's emergence. Since the 1980s many developing countries have adopted privatization programs. According to the way of market reforms and strategies the pace of privatization exceeds. The introduction of privatization (full blowing or partly), the developing countries sought the way to free their budgets from the burden of subsidizing loss-making enterprises. States now found themselves able to work for the building human capital and providing for human development. However, this does not mean that the privatization is the only way to pull back the country's economy from the deep economic crisis. But it was most preferred way the underdeveloped and developing countries, including that of socialist countries, which are facing the transformation. Enterprise reform is at the heart of transition in pre-socialist economies. As defined by the IMF, World Bank, OECD and EBRD, enterprise reform is the ownership reform; "Enterprise must be able to make decisions with the guidance of price signals. This will require financial autonomy, with owners and managers taking responsibility for the full range of business decisions and for the financial benefits and costs of those decisions. Experience shows that this is most likely to happen when assets are privately owned; private ownership also creates opportunities for individuals and reduces political interference in managerial decisions."<sup>31</sup>

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<sup>31</sup> IMF, World Bank, OECD and EBRD, *The Economy of the USSR – Summary and Recommendations* (Washington D.C., 1990), pp. 16 –17.

The state enterprises always remained as a hallmark of the socialist economies' control over the population of the country. The management of the SOEs proved helpful for proving state's indisputable socio-economic control over the country. The enterprise reform in the East European countries and Soviet Russia started taking place in the wake of shock method, where the state sector was regarded as a less important compare to the private enterprises' need. As the decision was made to transform the economy in to market socialism, the Eastern European economies were not very hesitant about opening their economy for both the incomers and out goers. The socialist countries considered as the shortest way to achieve the success. Since the transformation took place in the socialist societies with a rapid pace the private sector emerged at the cost of state enterprises. The word and the concept of privatization had hypnotized the socialist countries very much and in the Eastern Europe the 'spontaneous privatization' became the important tool of Enterprise reform. In Poland, the spontaneous privatization occurred under which deals were made with the outside partner. "Recommending privatization for all the sicknesses of the public sector has been linked to a doctor prescribing the same pink pills for all ailments."<sup>32</sup> Whereas, in China, the different measures were taken to make enterprises efficient, the case-by-case gradual privatization was comparatively successful. Lipton and Sachs feared these measures as time consuming and may continue for decades and that's why they were reluctant to implement this kind of reform strategy.

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<sup>32</sup> Andor, n. 20, p. 89.



In these countries, the abrupt shift to free pricing without first abolishing the state trading agencies was sabotaging the reform. Sachs and Lipton have also clearly underestimated the valuation problem in their schemes for immediate privatization. Even where rudimentary stock exchanges have emerged in Poland and Hungary the number of firms whose shares are traded (and thus susceptible to a kind of market valuation) is very small. Other state enterprises, upon examination prior to privatization, have proven to be unsuitable for purchase and woefully unattractive for legitimate foreign investors. The number of scandals over exploitative privatization by unscrupulous speculators has been one of the reasons for popular disaffection in both Poland and Hungary, and this has forced the governments involved to recast their privatization strategies.<sup>33</sup> Full sweeping privatization occurred in the socialized countries is not visible in China, Chinese leaders earlier the process of enterprise reforms started in the pre-communist countries feared to do so and continued with it's trial and error method of reform process, which now seems to be guiding the rest of the transforming economies: Even World Bank in its report *Beyond Economic Growth* says "In some cases, reducing the economic prominence of state enterprises is even possible without extensive privatization mainly by means of market liberalization that leads to accelerated growth of the private sector. That was the case in the Republic of Korea in the 1970s and 1980s and in China in the 1980s and 1990s." The Enterprise reforms in China took place gradually in steps and with sufficient

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<sup>33</sup> Robert F Miller, "Economic Reform in Former Communist Systems: The Problems of Privatization", Online at <http://eserver.org/>

years of gap. The reforms were taken periodically such as in 1978, 1984, 1991, and 1998.

### 1.5. Similarities

In comparison with the East European economies and the ex-soviet republics, the Chinese economic performance since 1978 looks extremely impressive. But there are similarities visible during their economic performance, such as:

1) "The reforms lack a clear goal model and guiding theory. Knowledge and theories are gradually picked up and summarized by a trial-and-error procedure."<sup>34</sup> Each time the policy decision taken in these countries are solutions to the earlier problem, and not a step towards a determined goal. This makes the path of progress obscure.

2) "Either because of political events, or because of economic situation, the reform process is cyclical. In China, for example, when time is favourable for reform, the government may eagerly pursue economic expansion instead, but when the situation changes, it is willing to accelerate reform measures because of the overall worsening of the situation."<sup>35</sup>

3) Social welfare cost and infrastructure building compete for getting priority, which complicates the resource allocation process and further give rise to debt and such financial crisis. "Reforms of Soviet type economies are often unable to overcome the transitional difficulties and are bogged down in a muddle

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<sup>34</sup> Kovacs and Tardos, n.15, p.197.

<sup>35</sup> *ibid.*, p.197.

characterized by inflation, debt crises, stagflation or sometimes, a combination of all these.”<sup>36</sup>

4) “Due to frequent changes of economic policies and their related theoretical explanations, it is difficult to infuse the public with confidence, and enthusiasm for the reform.”<sup>37</sup>

In spite of these similarities in Eastern European economies and the China’s economy, the reforms introduced in China were far more advanced than those introduced in other socialist societies. “The Chinese reform process was successful in moving state enterprises in to semi-private firms, without full blown privatization. This gradual transformation process gave enterprises greater autonomy over product decisions and allowed them to retain a greater fraction of profits. These reforms increased productivity.”<sup>38</sup> On all fronts, Chinese economy has performed astoundingly since the reforms began.

#### **1.6. Comparative Success of the China’s Reforms**

As discussed earlier, the contrast in institutional transformation between Central and Eastern Europe and the former Soviet Union on the one hand and China on the other, is often characterized as one of shock therapy versus gradualism. Hence the ways of introducing reform measures were different, the pace of change towards a ‘market economy’ varied. Because of the initial massive macro-disequilibrium existing in the former socialist economies, rapid stabilization and price liberalization were required, but those did not get

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<sup>36</sup> *ibid.*

<sup>37</sup> *ibid.*

materialize in practice and the system have not succeeded in duplicating the efficiency of a competitive market economy. Dicco and Hugo Radice observe that “The continuing poor macro economic performance of the central and East Europe and the former Soviet Union is at least in part due to the failure to carry through the shock therapy logic fully, for example in allowing the continuation of soft-budget constraints for large scale SOEs and ex-SOEs; while the good performance of the Chinese economy is partly because despite the continued existence of a soft-budgeted state-sector, the private and local state firms (township and village enterprises) have been ‘free’ to respond to market forces.”<sup>39</sup>

“The idea of market socialism is associated with the expectation that the ‘marketization’ of the socialist economy creates equilibrium of supply and demand. It is crucial litmus test of reform to see whether such equilibrium has been established.”<sup>40</sup> It is even ironic to note that major transformations in centrally planned economies go on being based on a central plan. The lack of planning and reform vision short of prudence has made the economic progress in socialist societies wayward. In the Soviet-type societies like Hungary, Poland, Yugoslavia, market socialism has been aborted before it could have proven its ultimate inability. Although the reformers in Bulgaria,

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<sup>38</sup> Husnu Kizilyali, *Economics in Transition* (Aldershot, 1998), p.210.

<sup>39</sup> Dic Lo and Radice Hugo, “ Institutional Change and Economic Development in East-Central Europe and China: Contrasts in the light of the ‘East-Asian Model’.” in Jeffery Henderson (ed.), *Industrial Transformation in Eastern Europe in the Light of the East Asian Experience* (New York, 1998), p. 138.

<sup>40</sup> Janos Kornai, “ The Hungarian Reform Process: Visions, Hopes and Reality”, in *Journal of Economic Literature* (London), vol. 24, no: 4, December 1986, p. 1715.

Czechoslovakia, and the Soviet Union and so on have also become finally aware of the certain point, genuine marketization is inconceivable without large-scale privatization, China's policy of gradualism is often contrasted with the proclaimed preference in Eastern Europe for rapid privatization."<sup>41</sup> Fischer, however, notes "in practice, privatization has proceeded slowly in Eastern Europe and has been disappointing, particularly for medium and large scale firms. In China, gradualist reforms started in agriculture and have not yet involved the sale of state farms to private individuals; yet an essentially private sector has developed in both agriculture and industry."<sup>42</sup> Although, the sale of state farms was not existed in China but 'Private Farming' was quite successful. "Private Farming, referred as the house contract responsibility system and perhaps the most significant of the agricultural reforms, allowed a great mass of peasants, perhaps 200 million people, to escape from dire poverty."<sup>43</sup> Fischer admits, "China's gradualist reforms have been extremely successful by any economic measures."<sup>44</sup> China's reforms, by contrast, were not conceived as a grand plan; rather they were consisted of small step-by-step changes. No ultimate goal was announced, nor any time table for transition. The data shows that the GDP of China during the years of transition was far healthier than that of its socialist counterparts. During the period of 1986-89 the average increase was 8.6 percent far ahead of other transforming socialist states. In 1992 when

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<sup>41</sup> Kizilyali, n.38, p. 80.

<sup>42</sup> Fischer (1992), as quoted by Kizilyali, n.38, p. 80.

<sup>43</sup> Becker, n. 9, p. 25.

<sup>44</sup> Fischer (1992), as quoted by Kizilyali, n.38, p. 80

the economic reform were on the its peak the annual GDP rate of China was 12.8 compared to Russia's -19.9(in minus), Bulgaria's -7.7, Czechoslovakia's -5.0, Hungary's -4.6, and Poland's 1.5 (See Table 1.1).

**Table 1. 1**  
**Economies in Transition: Annual Growth (% per annum)**

Country	Average			
	1986-89	1990	1991	1992
China	8.7	4.1	7.7	12.8
Russia	2.4	-2.0	-9.0	-19.0
Bulgaria	5.2	-11.6	-22.7	-7.7
Czechoslovakia	1.6	-3.0	-15.5	-5.0
Hungary	1.4	-4.0	-10.5	-4.6
Poland	2.7	-11.4	-7.7	1.5
Romania	-0.9	-7.1	-13.4	-10.2

Source: *China Statistical Yearbook 1992*; IMF, *Economic Review: Russian Federation, 1992*; *World Tables 1993*, and IMF, *World Economic Outlook 1993*.

China's example shows that there are specific characteristics of the centrally planned system that can be used to initiate a step-by-step reform process. Chinese reform is already moving along the track of multiple, joint ownership, vesting separate components of the traditional, Western- style property right in different kinds of owners. State ownership in the PRC has traditionally been divided between central and local governments. Since 1978 the course of Chinese reform has progressively if fitfully broadened the range of included stakeholders.

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## 1.7. Conclusion

It was the major shock for the Russian federation, in January, to suddenly and virtually decontrol all prices within the state sector and to stop trying to enforce normal patterns of delivery within that sector. As we have seen, this big-bang approach was very different from Chinese gradualism. On the other hand, some conditions in Russia were very different from those prevailing in China in 1979. Moreover, the reform government in Moscow was acting in good faith and seemed to be following the advice of international agencies like the IMF and World Bank and most of western economists. Peter Gowan argues that the aim of Shock therapy was to engineer sweeping institutional changes in the internal structures of these political economies to open them up to maximal western penetration and influence.<sup>45</sup> In other words the Shock therapy proved helpless to assist the transforming economies. The consequences of the Shock therapy were hopeless it did immense and unnecessary damage to economic life in the whole region. The shock therapy created a negative balance of trade. It disturbed the regions trade relations. The market socialism experiments have not been successful in socialist societies because the process of economic planning was abandoned in between without an adequate market system.<sup>46</sup> The experiment of market socialism with a gradual approach have possibly yielded better results (i.e. Hungary, Czechoslovakia and China) compared with the 'big bang'

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<sup>45</sup> Peter Gowan, "Neo-Liberal Theory and Practice for Eastern Europe", in *New Left Review*, no. 213, September – October 1995, pp. 1 – 60.

approach, which proved to be less successful (Poland), or chaotic (Russian example). It is now clear that the western economic thinkers poorly perceived the economic conditions of the socialist countries. The misinterpretation was of following kinds,

First, Western economic thinkers ignored the negative outcomes of the pursuit of their recommended policies in both the first and Third worlds.<sup>47</sup>

Second, they failed to appreciate the fundamental difference between Eastern and Western economic structure and behaviour.<sup>48</sup>

Third, the policy introducers neglected the domestic social and political conditions persisting in the Eastern European countries, as far as the restructuring of the economy was concerned. This inevitably led to widespread disenchantment with the entire transformation process.<sup>49</sup>

The experience showed that the mere theoretical as well as the policies without the understanding of the ground reality are bound to fail. As Andras Inotai argued, "Methods taken directly from economic theory, which have caused more harm than benefits, have spectacularly failed."<sup>50</sup> With the former Soviet Union in economic chaos and many central and East European countries

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<sup>46</sup> Inadequate market system means, partial price reforms affecting commodity market, absence of money and capital market, improper taxation system without private property rights and entrepreneurship.

<sup>47</sup> Andor, n. 20, p. 22.

<sup>48</sup> *ibid.*

<sup>49</sup> *ibid.*

<sup>50</sup> Andras Inotai, "The West and the Transformation of central and Eastern Europe", in Andor, Laslo and Summers, Martin, *Market Failure: A Guide to the East European Economic Miracle* (London, 1998), p. 22.



discovering that the market place can be cold and uncomfortable, the reasons behind their failure to achieve market socialism can be elaborated as follows:

1) In the socialist societies, the party give up running the economy and control its arbitrary exercise of political power. "Economic decision making remained politicised and subject to political monopoly, in order to ensure that market outcomes did not contradict the objectives of socialist equality."<sup>51</sup> These economies failed to successfully loose controls on the individual citizens to allow the operation of a labour market and to encourage individual entrepreneurial initiative.

2) Market factor did not exist and non-competitive atmosphere polluted the concept of market-socialism. "Domestic barriers to competition assured workers security by precluding the functioning of capital market that would have facilitated competitive investment."<sup>52</sup>

3) In these societies domestic product were kept outside the influence of market and competition, which severely hampered the product quality. As a part of this highly protectionist policy of International trade, foreign competition was ruled out.

4) Poor privatization policy one another reason of the failure. Market in these countries is characterized by the lack of private property rights. Lack of Private property rights and absence of private entrepreneurship has paralysed the progress of these markets, which were already advancing at a snail's pace.

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<sup>51</sup> Hillman (1992) as quoted by Kizilyali, n.38, p. 75.

<sup>52</sup> *ibid.*, p.76.

Political system, which is dominated by a single party, reduced the probability of partly privatization. "The political regime can be described by political monopoly rather than democracy; there is, however, no example of 'a democratic non-politicised system' that has denied private property rights."<sup>53</sup> Along with the process privatization, the sale of state's assets is also a must condition to achieve the aim, but in this case also East European countries and former Soviet Union failed.

5) The state did not discharge the responsibility to feed inefficient enterprises. They kept on backing those financially and allowed state to go bankrupt. The nourishments of soft-budget constraints did not allow state to emerge successfully from the economic crisis. The soft-budget constraints preclude success of macro-economic efficiency. "In the absence of privatization no one has the responsibility for capital, and whether the capital is utilized efficiently or not. In fact, management and labour capture capital and use it for self-advantage. Even there is incentive to incur loss and evoke subsidies in order to make higher wage payments."<sup>54</sup> Later it becomes very difficult to accept the bankruptcy and declare the state of chaos; hence the image of party and the ideology gets threatened it is virtually ruled out. The sickness of enterprises in these states spread like an epidemic, the bankruptcy of one enterprise proved highly contagious. "Enterprises lend each other money through accumulating arrears and thereby create 'chain indebtedness' wherein the bankruptcy of one

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<sup>53</sup> Kizilyali, n.38, p. 75.

<sup>54</sup> Hillman (1992) as quoted by Kizilyali, n.38, p. 75.

enterprise would lead to a series of bankruptcies, which would be politically unacceptable to the government.”<sup>55</sup>

The countries of Eastern Europe and the former Soviet Union have been flooded with advice from the west on how to liberalize their planned economies. As argued earlier, this advice is, unfortunately, offered in an empirical vacuum: no one knows how these economies will react to the proposed liberalization measures. There exists, however, a neglected source of information. China offers a long time-series of data covering over a decade to show the effects of reforms on a planned economy. China's reforms were gradual, but their cumulative effect has been large; and they have been remarkably successful. China's experiments provide some practical lessons on what kind of reforms can work elsewhere. For the socialist economies it is necessary to continue the reform process. Clearly, the reforms are not irreversible. “In both Eastern Europe (including the Soviet Union) and China, there appears to be a consensus on at least two key points: No one wants a return of the terror (as in the Soviet Union under Stalin or in China during Mao's Great Proletarian Cultural Revolution), and there is a shared desire for a better material life, and a better standard of living, after decades of scarcity and living with shortages.”<sup>56</sup> In China, the consumer revolution is probably the strongest popular force supporting the continuance of market reforms.

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<sup>55</sup> Kizilyali, n. 38, p. 75.

<sup>56</sup> Ness, n. 20, p. 19.

China's achievements compare favourably with individual performance in other large developing nations such as Brazil and India, particularly since these countries have enjoyed freer access to foreign assistance, expertise and technology than has the People's Republic.<sup>57</sup> In this case also the industrial development was remarkable and during the same period the growth of GDP of the country exceeded some of the advanced countries. (see Table 1.2)

**Table 1.2**  
**China's growth has been outstanding in the second half of this century average annual per capita GDP growth (percent)**

Country/Region	Period				
	1820-70	1870-1900	1900-50	1950-78	1978-92
China	0.1	0.7	-1	2.6	4.8
Latin America	0.2	1.1	1.6	2.3	-
Western Europe	0.9	1.2	1.0	3.2	1.4
United States	1.2	1.6	1.6	2.1	1.0

Note: - not available

Source: Maddison 1995 cited in World Bank, 'Understanding the Present'<sup>58</sup> and 'Annex One: Accounting for China's Growth', in *China 2020: Development Challenges in the New Century* (Washington D.C., 1997), pp. 1-5.

In the above graph it is clearly visible that the year of war (1870- 1950) made China's growth of GDP reach its zenith. During the tumultuous first half of this century, per capita income in China fell dramatically. Foreign occupation, civil

<sup>57</sup> Rawski, Rawski, Thomas G., "China's Industrial system", in U.S. Congress, Joint Economic Committee (ed.), *China: A reassessment of the Economy*, July 10 (Washington D.C.: US Government printing office, 1975) Reproduced in Chai, Joseph, C.H., (ed.), *The Economic Development of Modern China: Socialist Modernization 1949-1978* (vol. II) (Cheltenham: Edward Elgar Publishing Ltd., 2000), pp.112-135.

war, warlordism and anarchy caused great havoc. In the post-war period, under communist rule, the Chinese economy witnessed a steady growth, despite some hic-cups like Great Leap Forward and Cultural Revolution, which had caused considerable economic disruption and waste. The period from 1949 to 1978 was a period of experiments and the past experiences helped in shaping the future face of China's economy. In some cases efforts were made to compare Chinese experience with the west. This explanation doesn't disapprove the basic inefficiency and structural problems existed during Mao's era. And as a positive step to tackle the problems existing in the economy, the reform and restructuring at various levels started since 1978. And this could be possible only after sidelining the radicals. The market reforms introduced by Deng Xiaoping, not only promised the Chinese people an end to ideological campaigns and emphasis on consumption, but also this experience provides lessons for other transitional economies.<sup>59</sup> China under Deng started competing with other economic giants. It is also heading towards to be the real 'Middle Kingdom'. It is very necessary to understand the nature of Deng's economic policies.

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<sup>58</sup> World Bank, "Understanding the Present", in *China 2002: Development Challenges in the New Century* (Washington D.C., 1997), pp. 1-5.

<sup>59</sup> During the twenty years of Mao's rule, People's Republic of China's citizens were repeatedly traumatized by mass campaigns, and the average standard of living for a Chinese household barely improved at all. As a result, when Mao died in 1976 there was a widespread disgust with ideological manipulation by party leaders and a universal eagerness for a better material life. In the International sphere, the experience received from China by the transitional economies were both the Positive and Negative. Negative, for example – combining elements of the command and market economy, although reduces uncertainty and helps to maintain economic and social stability in the initial stages of transition, but also creates problems which become more acute with the passage of time (i.e. two-track pricing system, and policy towards SOEs). Among Positive lessons, first, piecemeal reforms can be cumulative and do not necessarily run out of impetus. Second, delegating economic decision-making to individuals and households.

## **Chapter 2**

### **Review of Economic Reforms in Deng's China**

## Chapter- 2

### Review of Economic Reforms in Deng's China

#### 2.1. Introduction

Deng Xiaoping is considered to be the 'chief architect' (*zong shejishi*) of Chinese reforms.<sup>1</sup> During his period, China achieved a high average rate of economic growth (in terms of GDP) than any other developing and developed country. It is during the same period, the whole economic structure was put under reconsideration. The chapter mainly focuses on the various issues related to economic development under Deng Xiaoping's rule. Apart from this, the chapter also tries to analyse the whole process of economic restructuring occurred during Deng's period. The chapter starts with the historical background and covers the main areas of economic development viz. urban and rural reforms.

#### 2.2. Historical Background

Prior to the introduction of reforms in 1978 the economy of China was highly subject to the vagaries of politics and Ideology; but since then the situation has rather been different. "Chinese leadership after 1949 translated the demands of a socialist ideology into economic processes and structures that could comfortably be labeled as 'socialist'."<sup>2</sup> Mao's concept of development

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<sup>1</sup> Lowell Dittmer, *China Under Reform* (Boulder, 1994), p.80.

<sup>2</sup> Suzanne Ogden, *China's Unresolved Issues: Politics, Development and Culture* (New Jersey, 1995), p. 259.

differed from the Western perspective<sup>3</sup> in the sense that it gave extraordinary importance to the ideological variables. In contrast to the western view of economic development, the Maoist conceptualization proposed economic development through a step-by-step resolution of contradictions, and each resolution would move China toward a higher mode of production in the Marxian economic perspective, until it reached communism.<sup>4</sup> Maoist perspective was that economic development entails the gradual elimination of 'the three great differences', the gap between the rural and urban life, between industrial and agricultural sectors, and between mental and manual labour. While eliminating the three gaps, any distinction of material wealth or social status deriving from property or roles also has to be eliminated.<sup>5</sup> The development determined the output, especially of heavy industrial producer goods. This model did not entirely ignore issues of efficiency and quality, but its priority was to increase output rapidly by meeting ever-larger production quotas. The path of accomplishing economic development was revolutionary, rapid and massive in nature. Mao believed that "to attain rapid change, politically conscious masses and cadres loyal to the CCPs vision were essential. Mao

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<sup>3</sup> In the west it is generally held that economic development encourages individuals to own the means of production and maximize profits. Resource allocation is determined by the price system. This also encompasses the belief that investment increases, as per capita income increases, and that consumerism and materialism accompany growth. Profit and efficiency are measures of economic development.

<sup>4</sup> Mao finds different kinds of contradictions in the course of China's bourgeois-democratic revolution. "There exists the contradiction between all the oppressed classes in Chinese society and Imperialism; the contradiction between the great masses of the people and feudalism, the contradiction between the proletariat and the bourgeoisie, the contradiction between the peasantry and urban petty bourgeoisie on the one hand and the bourgeoisie on the other, the contradiction between the various reactionary ruling groups."



thought that changes in people's mind, and hence in their behaviour, could be willed through thought reform."<sup>6</sup> This path was too hasty, since people were not familiar with this rapid way of transformation. During the Cultural Revolution, the Red Guards' attempt to remould people's mentality can be seen as a kind of exertion to reshape the thoughts of people. The belief that correct political thought could enhance production was very strong. Thus, political education was introduced in the factories for making work more effective.

During Mao's era, revisionist line of leaders was consolidating their stand. In China "two-policy lines emerged in the wake of the CCP's rejection of the soviet model: a radical and a revisionist line."<sup>7</sup> After the end of the First Five Year Plan, Mao tried to accelerate the economic reforms without Soviet assistance. He allowed each sections of the party to contribute. Launch of the Great Leap Forward (GLF) was an example of Mao's thirst for rapid economic growth. During the GLF, Mao waged a new economic development, which was different from that of the Soviet way. As Lieberthal observes, "Mao conceived of the GLF as a way to break out of the Soviet economic development model constraints, given China's very different factor endowment."<sup>8</sup> The lack of proper planning made the efforts disastrous. But Mao had allowed Liu Shaoqi and Deng Xiaoping to use their policy platform to facilitate the recovery of the economy

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*Selected works of Mao tse Tung* (Beijing, 1967), vol. I, p. 322.

<sup>5</sup> Ogden, n. 2, p. 264.

<sup>6</sup> *ibid.*, p. 264

<sup>7</sup> Dittmer, n. 1, p. 14.

<sup>8</sup> Kenneth Lieberthal, "The Great Leap Forward and the Split in the Yan'an Leadership, 1958-65," in Roderick Macfarquhar (ed.), *The Politics of China 1949-1989* (Cambridge: Cambridge University Press, 1993), pp. 87-147.

from the problems precipitated by the GLF. This gave them a chance to prove their ability through the renewed economic reforms. The policy drafted by the duo (Liu and Deng), “produced a series of investigations that provided the material used for pragmatic policy documents in major shares of work.”<sup>9</sup> It was since then the revisionist group came in to the flash point. These policies overall marked a dramatic shift from the priorities of the GLF. They brought experts and expertise back to center stage, produced greater reliance on modern inputs to achieve economic growth, re-imposed central bureaucratic controls over various spheres of activity, and appealed to the masses on the basis of the material self-interest than ideological mobilization.<sup>10</sup> The importance of the economy obviously started to be over weighing for the radicals. The growing importance of the duo and their flank made Mao worried. Mao subsequently complained that Deng did not consult him on policy matters after 1959. The failure of the GLF and the increasing power of the duo eroded Mao’s fame, which the later was scared of. Mao found that in 1962 he was not able to assume full control of the policy flow and to twist the meaning of his directions such as those on rectification. These were some of the prime reasons behind the launch of Cultural Revolution. Mao had grasped the vitality of economic factor. In fact, earlier Mao had tried to initiate economic reforms through GLF, but could not extend it to the common people because of the ideological legacy.

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<sup>9</sup> ibid.

<sup>10</sup> ibid.

After the end of the Cultural Revolution the activities of the revisionist group increased and the flank believing in the economic transformation reinforced. "Revisionist line emerged in pragmatic response to the difficulties that radicalism had inadvertently precipitated."<sup>11</sup> Revisionist line was less utopian, and saw increased materialism and consumerism, greater material incentives as necessary ingredients of economic growth. They also had a hope of achieving communism some time in the distant future. Initially Liu Shaoqi and Deng Xiaoping advocated this stand.

The history of the Mao's era can, at one level, be depicted as a series of political campaigns by Mao to assert and maintain absolute power. In 1956 the Hundred Flowers campaign was launched to encourage free speech under the 2000-year-old slogan 'Let a hundred flowers blossom and a hundred schools of thought contend.' This was the anti-rightist campaign, when over half a million intellectuals were punished, many scholars fell victim. In 1958, under the programme of Great Leap Forward, the peasantry was stripped off their possessions and amalgamated into giant communes. The famine that resulted caused the death of hundreds and thousands of people. In 1966, Mao embarked on the Cultural Revolution, attacking his critics among the leadership, dismantling the bureaucracy, persecuting intellectuals and encouraging Young Red Guards to unleash terror.

The experience of Mao's era was unforgettable for the common Chinese, because of its ideological orientation. "The regime was no longer able to

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<sup>11</sup> Ogden, n. 2 , p. 14.

legitimize its rule by appealing to a vision of communist utopia. People had become skeptical of the party's programmes and of its right rule."<sup>12</sup> In 1979, Deng Xiaoping established full control over the party at the Third Plenum of the Eleventh Party Congress and embarked on a programme of reform.

The false decisions of Mao, allowed enough room for revisionist line to emerge. And the efforts were made to transform the economy in a revolutionary way by freeing it from the paws of ideology, through paradigmatic shift into economic thinking. Deng Xiaoping saw this as a part of new revolution and termed it as the 'Second Revolution'.

### **2.3. The Second Revolution**

While defending his struggle for the second revolution, Deng, at one place said, "The reforms we are now carrying out are very daring. But if we do not carry it out, it will be hard for us to make progress. Reform is China's second revolution. It is something very important that we have to undertake even though it involves risks."<sup>13</sup>

Deng Xiaoping's concept of development varied from that of the Mao's. His ideas were based on both the actual condition and the principle of Marxism-Leninism and Mao Zedong's thoughts. Deng pointed out, "both in revolution and construction, we should also learn from foreign countries and draw on their experience. But the mechanical copying and application of foreign experience

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<sup>12</sup> Andrew J. Nathan, *China's Transition* (New York, 1997), p. 59.

<sup>13</sup> *ibid.*

and models will get us nowhere. We have had many lessons in this respect. We must integrate the universal truth of Marxism with the concrete realities of China, blaze a path of our own and build a socialism with Chinese characteristics- that is the basic conclusion we have reached after summing up long historical experience.”<sup>14</sup>

Deng Xiaoping’s pragmatic economic thinking brought changes in China’s development process that occurred in the 80s. These ideas later became the basis for the reforms that began in 1978. Deng did not negate the importance of Mao’s ideas and he even did not allow western notions to take control of the Chinese economy, this proved as a great contribution of Deng. “Deng managed to identify himself as an opponent of the cult while avoiding any Khrushchev like explicit criticism of Mao or his thought. He did so by quoting Mao’s own words in support of a pragmatic rather than a dogmatic interpretation of Maoist Doctrine and explicitly confronting the supposition that Mao’s thoughts were infallible with reasoned counter arguments.”<sup>15</sup>

As far as the reform process in post-1978 China is concerned, there was unanimity (among ruling elites) in the belief that the utter pragmatic style of thinking would bring the economic progress. With the reforms, an attempt was made to achieve ideological flexibility with the slogan ‘practice is the sole criterion for testing truth’. With Deng Xiaoping taking over the position of *de facto* leadership within the Politburo at the third plenum of the Eleventh

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<sup>14</sup> Text of Deng Xiaoping’s opening speech at the Twelfth National Congress of the CCP in *Selected Works* (Beijing, 1984), p. 395.

Central Committee (ECC) (in December 1978) the reform era was formally inaugurated. But the actual pragmatic reform efforts started only after the Fifth plenum of ECC. “The fifth plenum of ECC marked the end of the transitional period from ‘politics in command’ for Deng’s ‘economics in command’ hoping to turn China into an advanced nation by the year 2000.”<sup>16</sup> This was the time when China’s modernization within the framework of socialist ideas began. According to Deng Xiaoping, this path was revolutionary. “Modernization does represent a great new revolution. The aim of our revolution is to liberate and expand the productive forces. Without expanding the productive forces, making our country prosperous and powerful and improving the living standards of the people, our revolution is just empty talk. We oppose the old society and the old system because it oppressed the people and fettered the productive forces. We are clear about this problem now. The gang of four said it was better to be poor under socialism than to be rich under capitalism. This is absurd.”<sup>17</sup> Here it is very necessary to understand the real zeal behind Deng’s initiative in introducing a new revolution. Based on some of the assumptions that China is strong enough to face a new round of reform, Deng did not hesitate to begin the reform process, and he could see the favourable condition for the success of reforms. The favourable conditions were as follows: first, Deng was confident about the natural resources. He knew the potentiality of these in the future

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<sup>15</sup> Dittmer, n. 1, pp. 25-26.

<sup>16</sup> Immanuel C.Y Hsu, *The Rise of Modern China* (Hong- Kong, 1983), p. 799.

<sup>17</sup> Deng Xiaoping, “Develop a Market Economy under Socialism”, *Selected Works of Deng Xiaoping*, vol. II (1975-1982), from the website – [www.english.peoplesdaily.com.cn](http://www.english.peoplesdaily.com.cn)

development. "We have abundant natural resources. China is a country with vast territory and abundant energy and mineral resources, including almost all the ferrous, nonferrous and rare metals. If these resources are exploited, they will produce great economic power."<sup>18</sup> Second, Deng never negated the contribution made by the earlier reform efforts. For him it was just like laying a preliminary material foundation for industry, agriculture, science and technology. Third, since the intelligence of Chinese people was not allowed to flourish and it was everything suspiciously kept away from the creative contribution to the country, Deng believed that the mental restraints imposed by Lin Biao and the Gang of Four shackled people's thinking and restrained them from bringing their wisdom and creativity into full play. He had a strong belief in people's will. He said; "We should arouse the initiative of our people. As long as we put to use the wisdom and intelligence of the people, China has high hopes."<sup>19</sup> Fourth, Deng Xiaoping was very optimistic in getting help from the outside world. Deng believed that foreign funding was also very necessary. With these arguments Chinese leaders and the majority of the people were convinced about the success in the modernization programme. The Leadership summed up a new ideology appropriate to the period of reform in the phrase 'socialism with Chinese characteristics'.

The four modernizations have a special place in China's modernization process, the four modernizations have been written into the party Constitution

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<sup>18</sup> *ibid.*

<sup>19</sup> *ibid.*

(Eleventh congress, August 18, 1977) and the State Constitution (Fifth National People's Congress, March 5, 1978).<sup>20</sup> The four modernizations were, of agriculture, industry, science and technology and defense. The Gang of Four, which condemned modernization as a 'road to capitalist restoration' always tried to impede the process. As the political confrontation with the Mao's wife was a risk, Deng had a very difficult time as long as the Gang of Four had Mao's support. Not until the smashing of the Gang in October were the four modernizations revived. After the fall of the Gang, Deng again defended the four modernizations. "The gang of four did not allow us to do so, calling this a slavish comprador philosophy. Science and technology have no class nature; capitalists make them serve Capitalism, and socialist countries make them serve socialism. Ancient China had four great inventions (paper, printing, gun power and the compass), which later found their way to countries around the world. Why then should we be hesitant about making use of advanced technologies and achievements from around the world? We should make advanced technologies and achievements the starting point for our development."<sup>21</sup> Deng had numerous expectations from the modernization process; he wanted to raise the country

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<sup>20</sup> Deng Xiaoping did not introduce an idea of Four Modernizations. Zhou En-Lai is generally credited with initiating the idea of the Four Modernizations. At the Third National Peoples Congress, December 1964, he proposed the socialist construction of a 'modernised agriculture, industry, national defence, and science and technology' to be accomplished 'within not too long period of history. However, no concrete action followed due to the onset of the Cultural Revolution. Deng, during his speech at the Fourth National Congress in January 1975, extended Zhou En-Lai's modernization and renewed his call for an independent and relatively comprehensive industrial and economic system, by 1980, an overall modernization of the four sectors before the end of the century, which is considered as the basis of the current Four Modernizations.

<sup>21</sup> Deng Xiaoping, "Realize the Four Modernizations and never seek Hegemony", *Selected works of Deng Xiaoping*, vol. II (1975-1982), from the website – [www.english.peoplesdaily.com.cn](http://www.english.peoplesdaily.com.cn)



from the third world status. He led the new revolution with a motto 'less talk, more action'.<sup>22</sup> "... this is a great revolution in which China's economic and technological backwardness will be overcome and the dictatorship of the proletariat further consolidated. Since its goal is to transform the present backward state of our productive forces, it inevitably entails many changes in the relation of production, the superstructure and the forms of management in industrial and agricultural enterprises, as well as changes in the state administration over these enterprises so as to meet the needs of modern large-scale production. To accelerate economic growth it is essential to increase the degree of specialization of enterprises to raise the technical level of all personnel significantly and train and evaluate them carefully, to greatly improve economic accounting in the enterprises and to raise labour productivity and rates of profit to much higher levels. Therefore, it is essential to carry out major reforms in the various branches of the economy with the respect to their structure and organization as well as to their technology. The long-term interests of the whole nation hinge on these reforms, without which we cannot overcome the present backwardness of our production technology and management."<sup>23</sup> In the March 1979, Deng in his effort to solve the tension between the conservatives and

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<sup>22</sup> *ibid.*

<sup>23</sup> Deng Xiaoping, "The Working class should make outstanding contribution to the Four Modernizations", *Selected works of Deng Xiaoping*, vol. II (1975-1982), from the website – [www.english.peoplesdaily.com.cn](http://www.english.peoplesdaily.com.cn)

reformists came up with an idea of four cardinal principles.<sup>24</sup> Deng in a major speech given on 30th March 1979, at a forum on the principles for the CCP's theoretical work, had declared these four as 'the basic prerequisites for achieving modernization' and enunciated them as follows:

- We must keep to the socialist road.
- We must uphold the dictatorship of the proletariat.
- We must uphold the leadership of the Communist party.
- We must uphold Marxism-Leninism and Mao Zedong's thoughts.<sup>25</sup>

Deng later declared that the essence of four cardinal principles is to uphold Communist party leadership. He justified the superiority of the party. Deng, however, made it clear that these reforms aimed to promote, not dissolve Chinese communism.

Along with the concept of four modernizations, Deng had some ideas about the current and future economic work. During his talk at a forum of the first secretaries of the provincial, municipal and autonomous regional committees of the CCP on October 4, 1979, he discussed some of those,

1. "Economic work is a political task of prime importance and the economic question is an overriding political question."<sup>26</sup> I think that we must concentrate on

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<sup>24</sup> Democracy Wall Movement shows that how in the Post-Mao China, with the gradual relaxation, various political demands emerged. The movement was in favour of political liberalisation, and till some extent supported by the reformers, to challenge the left. With the Four Cardinal principles Deng Xiaoping showed his commitment to Marxism-Leninism-Mao Zedong Thoughts, party leadership, socialism and the proletariat dictatorship. This step was in a way to balance the going on clash between the two sides.

<sup>25</sup> Deng Xiaoping, "Uphold the Four Cardinal Principles", *Selected Works of Deng Xiaoping*, vol. II (1975-1982), from the website – [www.english.peoplesdaily.com.cn](http://www.english.peoplesdaily.com.cn)

economic work for a long time to come.”<sup>27</sup> He emphasized on the economic work rather than petty-political issues, he wanted economic development to be the central task of party committees at all levels. “To create more jobs, Beijing, Tianjin and Shanghai are practicing collective ownership. They are using economic policies to settle political problems. In solving such problems, we should have a broad outlook and adopt flexible policies. In a word, we should use economic methods to solve political and social problems.”<sup>28</sup> Deng’s thinking was revolutionary because the political and economic sectors were never separated from each other. Deng separated the economic thinking from that of the ideological thinking and made it core of the Chinese developmental process. His main emphasis was now to calm down the radicals from criticizing the reforms with the means of social achievements.

2. The educating of people and socializing them towards the changed situation and necessities was the next step. Deng inclined to encourage people ‘scientifically’, which are according to realistic principles, without ‘practicing fraud or chanting empty slogans’.

3. While building the country’s economy, Deng without hesitating accepted a use of foreign capital. He persuaded the minds of his fellow party workers by giving an example of those countries, which stood from the ashes. He said, “No matter what category foreign capital belongs to, we should utilize it, because the

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<sup>26</sup> By the political task, Deng refers to the Four Modernizations.

<sup>27</sup> Deng Xiaoping, “Some Comments on Economic Work”, *Selected Works of Deng Xiaoping*, vol. II (1975-1982), from the website – [www.english.peoplesdaily.com.cn](http://www.english.peoplesdaily.com.cn)

<sup>28</sup> *ibid.*

chance to do so do not arise often and it is a great pity if we do not make use of this opportunity.<sup>29</sup> After World War II, some countries devastated by war, including a few European countries and Japan, developed by using loans, but mainly by importing technology and patents. If we can make good use of this opportunity, we may attract even more foreign capital.”<sup>30</sup>

4. Deng Xiaoping was well aware of the state of China’s financial system. He had aimed to grant more decision-making power to the enterprises, operating banks on a commercial basis etc. Exactly this was the key factor, which later proved important in the process of economic reforms. He discusses, “I should like to talk about our system. Is our financial system centralized or decentralized? I think that it is inadequately decentralized. Since the central authorities control only limited revenue, can this really be called a centralized system? On the whole, our financial system is comparatively centralized. We need to delegate some financial resources to local authorities so that the latter have more financial power and more room for maneuver. This is the general financial principle we should establish.”<sup>31</sup> Deng has understood the nature of the problem and stressed for a consensus. Deng warned that “...if we cannot reach a consensus, in which case it will be very difficult to solve problems.”<sup>32</sup>

5. Deng in his speech *Some Comments on Economic Work* talked about the ‘economic readjustment’ as one of his economic ambitions. Vice-Premier Chen

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<sup>29</sup> Earlier to this Comrade Chen Yun classified foreign capital in to two categories: invested foreign currency and loans for equipment.

<sup>30</sup> Deng, n. 31.

<sup>31</sup> *ibid.*

Yun's understanding of readjustment as "more emphasis on planning than development of markets",<sup>33</sup> later influenced the thinking of Deng Xiaoping and brought clarity in it. "I fully agree with comrade Chen Yun's speech. He correctly summed up our experience in handling series of problems in economic work over the past 31 years and the lessons we have drawn from it. His statement will serve as our guide in this field for a long time."<sup>34</sup> Speaking about the necessity of this he said, "Why should we carry out the necessary readjustment and curtailment in some fields during the four modernizations? Because if we do not, we will be unable to ensure the steady growth of the economy."<sup>35</sup> Deng envisioned a stable and a healthy growth of the economy.

Deng also gave importance to the 'time-management' and stressed on practical results and on solid work to improve the variety of products and their quality. "Improving the quality of products is the most important issue facing economic readjustment."<sup>36</sup>

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<sup>32</sup> ibid.

<sup>33</sup> Marc Blecher, *China Against Tides* (London, 1997), p. 98.

<sup>34</sup> Deng Xiaoping, "Implement the policy of Readjustment, ensure Stability and Unity", *Selected Works of Deng Xiaoping*, vol. II (1975-1982), from the website – [www.english.peoplesdaily.com.cn](http://www.english.peoplesdaily.com.cn)

<sup>35</sup> ibid.

<sup>36</sup> Deng, n. 31.

## 2.4. The Contents of Reforms

### 2.4.1. Restructuring of the Economy

The borrowed Stalinist strategy and the Maoist development principles could not raise the country's economy more than average.<sup>37</sup> The main thrusts of the reform policies were to restructure the national economy.<sup>38</sup> Restructuring means a fundamental reform of the entire system, it has far reaching implications. It was very necessary to rearrange the established machinery, in a way to introduce reforms. The success of economic work suggested by Deng Xiaoping was depended on this re-arrangement. In the Deng's China, the restructuring process concentrated, widening avenues for the sale of primary and the processed products goods, conserving the concept of profit, and the decision of right investment.

After the triumph of the socialist revolution China has gradually established a socialist economic system characterized by public ownership, which opened up a road for the country's socialist development and its people's well being. The change in the structure of national economy became inevitable because of the change in priorities. "This shift in priorities from defense and heavy industry to agricultural and light industry has of course led to a significant

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<sup>37</sup> Soviet model also adopted the priorities set by Stalin and his central planners that is heavy emphasis on the high rate of investment and rapid growth in heavy industrial production, especially the basic metals and machine building industries. And this development was tried to achieve at the cost of agricultural development. China has also implemented the Stalinist development strategy throughout the quarter of a century before the death of Mao.

<sup>38</sup> The process of restructuring was different from that of readjustment. Restructuring is necessarily more difficult and time consuming than readjustment. The focus of readjustment is mainly short run. In view of existing imbalances, their correction has a special urgency and is expected to show results within a relatively short period of time.

increase in the supply of consumer goods and the level of living”<sup>39</sup> and the restructuring of the economy aimed to speed up modernization. “The country’s industry, agriculture, science and technology and national defense inevitably saw the need for the reform of those aspects of the relations of production and the super-structure, including forms of management and activities and ways of thinking, that were not in conformity with the growth of the productive forces.”<sup>40</sup> The complex domestic economic reform programme undertaken since 1978 can be summarized in three propositions: private ownership can occupy a useful place in a socialist economy, market forces should be allowed to influence the allocation of goods and the determination of prices, and material incentives should be the principal mechanism for stimulating greater productivity and efficiency. And these steps allowed individuals to start their own businesses, managers to enjoy greater autonomy in running their factories, state officials to exercise less direct administrative control over economic activity, and awards with higher levels consumption to productive workers.<sup>41</sup> The initial phase of experimenting structural reform in Chinese economy started during the third plenum. In both industry and agriculture, markets were opened to handle the distribution of the above-quota production. This initial phase saw many negative repercussions of the restructuring process. Since the restructuring

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<sup>39</sup> Robert F. Dernberger, “China’s New Economic Development: Problems and Prospects”, in Norton Ginsberg, and Bernard Lalor, eds., *China :The 80s Era* (Boulder: Westview Press, 1984) p.127.

<sup>40</sup> Liu Guoguang and Wang Ruisun, “Restructuring of the Economy”, Guangyuan, Yu (ed.), *China’s Socialist Modernization* (Beijing Language Press, 1984), p. 74

<sup>41</sup> Harding, Harry, *China’s Second Revolution: Reform after Mao* (Washington D. C., 1987), pp. 99-100.

and reforms were new for the inexperienced Chinese, the success rate was low. These early reforms threw the Chinese economy into serious imbalance. As enterprises and local government agencies retained a larger share of their profits, state revenues declined, and the national budget went into deficit. The expected rate of investment was crossed over. "Imports, especially of capital goods, increased faster than exports, and China experienced a combined foreign trade deficit of \$ 3.90 billion in 1979-80, the largest in its history."<sup>42</sup> Since the local authorities and enterprises were awarded with the extended decision-making power, they now have capital to invest. But the question was where to invest it? Because the local authorities and enterprises did not know the national market situation and had no idea of what to develop and what not and the higher authorities did not have a unified plan or necessary guidance to give.<sup>43</sup> The efforts were taken to avoid further deterioration of the country's economic health. Investment was slashed, the economy slowed, budget expenditures reduced, and the trade deficit trimmed. Further economic reforms were also postponed.

The changes in the total level of investment and its allocation within the urban industrial sector have demonstrated the post-Mao leadership's dramatic rejection of the Stalinist model. Because of extra care, light industrial production became greater than heavy industrial production for the first time in 70s. "As a result of this restructuring of allocation of priorities for investment and

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<sup>42</sup> Harding, n. 41, p. 71.

<sup>43</sup> Guoguang, n. 40, p. 135.



production, it is clear that the post-Mao leadership has rejected the 'big-push' strategies of the Stalinist model for those of 'balanced' growth."<sup>44</sup> After two years of rethinking, new moderate kind of economic reforms were introduced. One of the most important documents on structural reform was adopted on 20th October 1984 at the Third plenum of the 12th party central committee. The documents contain the following goals:<sup>45</sup>

(1) to secure a dynamic socialist economic structure; (2) to invigorate enterprises as the key to restructuring the national economy; (3) to devise a planning system for 'developing a socialist commodity economy'; (4) to establish a 'rational price system'; (5) to separate government from enterprise to allow the enterprise to perform its proper economic function; (6) to create various forms of economic responsibility system and to implement the principle of distribution of reward according to one's work; (7) to develop diverse economic forms to expand foreign and domestic economic and technological exchanges; (8) to promote a new generation of cadres and a contingent of managerial personnel for the future economy; and finally (9) to strengthen party leadership in the reform process and its success.

The result of the restructuring was mixed in nature. It transformed the agriculture from a collective undertaking to a family enterprise. For the enterprise, the moderate reforms have given more autonomy in decision-making,

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<sup>44</sup> Dernberger, n. 39, p. 125

<sup>45</sup> *China's Economic Structure Reform- Decision of the CPC Central Committee* (Beijing, 1954) Cited in David Wen, and Wei Chang, *China Under Deng Xiaoping: Political and Economic Reform* (London, 1988), p. 162.

more control over the allocation of profits, and more responsibility for the outcomes of their decisions. Reforms were responsible for bringing changes in urban and rural areas. Primarily, reforms had been more successful in the rural areas than in the cities. Urban reforms were given second preference.

## **2.4.2. Urban and Rural Economic Reforms**

### **2.4.2.1. Rural Economic Reforms**

The most important economic sector in terms of China's modernization is agriculture. The post-Mao period saw an end of collectivized agricultural system. Agricultural policies de-emphasized collective farming and actively promoted individual farming.<sup>46</sup> The two main aspects of rural economic reforms were the Household Contract Responsibility system (HCRS) and changes in marketing practices, were introduced in the early stage of agricultural reform, these were the most notable reforms in the rural sector. Under the HCRS, introduced in 1979, individual households enter in to contracts with the state for the production of agricultural products, especially grain and some cash crops, on land leased from the state. The HCRS permitted the abolition of the communes, formerly the highest level of collective organization in the countryside. Their control over agricultural land has been transferred to the smaller production

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<sup>46</sup> Jasper Becker has given an interesting explanation of this process. "After the Mao's death almost immediately, and perhaps spontaneously, the peasants began to divide up the land and grow food as they thought fit instead of following state directives. According to the party's history, the first to do so were a group of peasants in Fengyang County in Anhui, who signed a secret compact in 1977. In 1978, Deng Xiaoping...officially endorsed the Anhui experiment and began to dissolve the communes, authorising the adoption of the Household Contract Responsibility System.

brigades. The system successfully created the possibilities of incentive and initiative. With that the system spread to the various parts of the country. Giving major decision-making powers to individual peasant households, it undoubtedly aroused peasant enthusiasm. The introduction of the HCRS was accompanied by the changes in agricultural marketing and state procurement practices. The state increased procurement prices by 17.1 percent, 20 percent for grain at the cost of 7.99 billion Yuan.<sup>47</sup> In addition, the quotas for mandatory deliveries to the state were frozen, allowing farmers to sell an increasing share of their annual output at the higher prices paid for above quota production.<sup>48</sup> “In 1979, the state’s budget included provisions for price increase for quota and above quota purchases and reduction and remission of agricultural taxes.”<sup>49</sup> The HCRS brought changes in marketing. Increases in government procurement prices for grain and other agricultural commodities proved to be very effective in boosting production. A kind of specialization emerged in the agriculture sector. With the relaxation of mandatory sales to the state, peasants were relatively free to choose what they wanted to grow, depending on their own expertise and natural conditions. They could concentrate on a single crop or develop other lines of work. The nouveau concept emerged from this; it was the specialized household, which was defined by James Ethridge, “a household that devotes its ablest

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<sup>47</sup> Collin Mackerras and Pradeep Taneja, and Graham Young, *China since 1978: Reform, Modernization, and Socialism with Chinese characteristics*. (New York, 1994), p. 68.

<sup>48</sup> Since the early 1950s, the Chinese government had used the ‘unified purchase’ (*tongguo*) system as the keystone of its grain control policy, procuring grain and other agricultural commodities from the rural areas at fixed prices and then selling them to urban residents at prices lower than the procurement prices.

<sup>49</sup> Demberger, n. 39, p. 126.

workers and at least 60 percent of its work time to a single crop. Product, or service (such as vegetables, poultry, or transport); sells at least 80 percent of its products (60 percent for grain producers) and has an income from sales of its products or services at least double the average of other local families.”<sup>50</sup> This trend helped peasants as well as consumers.

In the third plenum of the twelfth Central committee, the steps were taken to accelerate change in agriculture. The main thrust of this was on improving marketing for agricultural commodities. The transport service was also brought into focus. Initiatives in this area were outlined in the principal rural policy document for 1985. The major changes outlined in the document were:

- Replacement of the old unified purchase system by a new contract purchase system for the major crop commodities;
- Decontrol of prices for less important crops and many livestock products;
- Increases in fixed prices for many foods sold to the urban residents through state shops, which coincided with prices' rise in urban free markets.<sup>51</sup>

Before this new policy, even after the readjustments of the early 1980s, the state monopoly over the marketing of major crops had been maintained. The new system was seen as a move towards the elimination of state monopoly purchasing, introducing supposedly voluntary state contracts with individual peasant households involving cotton, major grain and oil seeds. Now peasants were allowed to receive higher than quota price for 70 percent of their sales and

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<sup>50</sup> James Ethridge, *Changing China*, quoted by Mackerras, n.47, p. 71.

<sup>51</sup> Mackerras, n. 47, p. 73.

the lower basic price for the remaining 30 percent. The conditions of peasants were changing rapidly, since their day-to-day needs having been met; farmers were in a position to save. And farm households took over as the main investors in the rural economy, whereas previously the state was virtually the only investor.

Next to the decollectivization of agriculture, the most striking economic transformation in China since 1978 has been the rapid growth of rural nonstate industry (TVEs).<sup>52</sup> The neglected TVE sector was allowed to spread in rural areas of China.<sup>53</sup> During Mao's period the rural industrialization had a poor record, which further delayed the country's schedule in building a modern industrial network. Before the communist party's third plenum in 1978, the village had very little sideline production. As Byrd and Gelb observes that this certain degree of rural industrialization occurred within the confines of an administrative straitjacket. Since the reforms of 1978 the development of the TVEs had been the integral part of rural and agricultural reforms. People started small business in the country-side engaged in artisan production or services like barbering, bicycle repair, such and other sideline production developed rapidly in villages. In 1980 the proportions had changed to such an extent that over 50 percent of the population was working in sideline production or rural

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<sup>52</sup> TVEs consist of collective, partnership and individually-owned enterprises in the rural area.

<sup>53</sup> The Great Leap Forward of the late 1950s led local governments to establish numerous rural small-scale industrial firms, but most of them turned out to be unsustainable. After that those were poorly looked after by the state.

industries.<sup>54</sup> And this was followed by the swift growth in its industrial enterprises. In 1987, limits on the size of private firms, which had been enforced, were lifted. These changes altered the previous economic structure of the village, in which 90 percent of the population engaged in farming. In the initial stages these industries absorbed vast surplus of rural labour. “In their heydays (1985 to 1995), rural enterprises were creating up to 12 million new jobs a year, and in the 1980s they absorbed 80 million surplus rural labourers.”<sup>55</sup> Compared to the performance of SOEs, TVEs are definitely ahead with the largest bulk in the total industrial output. TVEs emerged as the fastest growing sector in the economy. “In 1978, TVEs produced only 9 percent of the industrial output in the country. From 1978 to 1995, TVEs’ output value grew at an annual average rate of 24.7 percent, and its employment rose at an annual average rate of 9.3 percent. In 1995, TVEs produced 56 percent of the total industrial output.”<sup>56</sup> All this quickly produced a rural society that was far more complex and differentiated than it had been in the Maoist period. In the Marxian sense of class, there were now several classes engaged in the structure of production.

#### **2.4.2.2. Urban Economic Reforms.**

The new economic reforms in post-1978 China earlier of their reform efforts focused on the Agrarian sector. Deng’s policies were responsible for

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<sup>54</sup> Fei Xiaotong, *Chinese Village Close-Up* quoted by Wen, David and Chang, Wei, *China Under Deng Xiaoping: Political and Economic Reform* (London, 1988), p. 162.

<sup>55</sup> Jasper Becker, “Slump in country side deepens as bubble bursts for rural enterprises”, cited in Becker, n. 24, pp. 79-80.

arranging further industrial reforms in 1984. Earlier to this, he was engaged in the process of reforming Rural China, and when the agrarian sector was released from the control of Government, it was easy to arrange the line of supply of raw material according to industrial needs in urban China. Gradually, this led to the return of confidence and living conditions were so improved that Deng was ready to launch a greater urban economic reform plans. "Deng's urban economic reforms followed his success in rural reforms. He had allowed a larger plot of land to each farmer, encouraged more sideline private production, permitted rural free marketing, improved individual income, and enlivened light industry growth throughout rural China. Deng made rural economic revitalization the cornerstone of urban industrial development."<sup>57</sup> The major policy change, rather massive urban economic reform measures took place in October 1984.

The measures concerned with urban area were:<sup>58</sup>

(1) Reform in price systems and utilization of all economic levers for competition in production and management efficiency; (2) separation of government from enterprise in the later's internal decision-making and operation through enterprise autonomy and internal collective decision making; (3) institutionalization of responsibility and accountability through wage differentials and salary reward; (4) development of diverse economic forms in

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<sup>56</sup> Ma, Jun, *The Chinese Economy in the 1990s* (London, 2000), p. 114.

<sup>57</sup> Ma Hung, *New Strategy for China's Economy* quoted by David Wen and Wei Chang, *China Under Deng Xiaoping: Political and Economic Reform* (London, 1988), p. 162.

<sup>58</sup> Decision of the Central Committee of the Communist Party of China on reform of the economic structure, adopted by the Twelfth Central Committee of the CPC at its Third Plenum, cited in David Wen and Wei Chang, *China Under Deng Xiaoping: Political and Economic Reform* (London, 1988), p. 162.

both domestic and foreign economic exchanges, (3) training of a new generation of cadres and a managerial personnel for the new socialist economy.

The enhancement of the market was made with the withdrawal of state from the decision-making process. With the decentralization, a kind of dual system emerged, where the plan and the market play parallel coordinating roles in the allocations of resources and in the distribution of products. Centralized planning as a means of economic regulation has certainly lost its importance in the Deng's era. The chance of profit maximization through increasing output (above plan output) selling in the open market almost led to the demise of mandatory system. The other major measure was that state accepted the price factor to accelerate the reform process. The economic decision-makers were aware that unless factory prices are successfully readjusted to reflect their real values, attempts to reform the economic system would achieve little success. Once the role of market is expanded, the decontrol of prices was obvious. On the one hand, the price flexibility reflected the market demand and supply relations more directly,<sup>59</sup> whereas, on the other hand, for the urban Chinese the inflation

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<sup>59</sup> Here by Price flexibility, I mean the negotiable scene in price fixing. The layers of prices are introduced for different categories. There are now four types of prices in China:

1. Planned prices or state fixed prices, applied to materials and services covered by the mandatory state plan.
2. Floating prices, with upper and lower limits – another kind of planned price.
3. Negotiated prices, for non-staple agricultural products and some consumer goods, set through negotiations between local and provincial governments and the producers.
4. Free-Market prices, applicable to manufactured goods not covered by state plans and to goods sold in the free market, determined by the producers and retailers according to demand and supply.



caused for worry. With prices changing every day, they no longer felt financially secure.<sup>60</sup>

The power related product priority, its production and distribution and sale were left with the enterprises only. The theme 'responsibility is equal to (=) profit' became popular. With the reduction in state planning and involvement and increase in enterprises responsibility, the scope of economic development widened. A concerted industrial reform started in 1984, "enterprises have been granted greater power over the production, pricing, and distribution of above-quota or non-planned output and over the hiring, promotion, remuneration and dismissal of their workers."<sup>61</sup> State enterprises were allowed to retain a share of their profits and to sell independently a part of their output that exceeded mandatory state quotas. Urban workers also face a much different economic environment under the post-Mao reform, whereas, the part of education in secondary schools, technical or vocational training was given little attention. Following graduation, state labour bureaus aligned workers to industrial enterprises and commercial establishments for what amounted to unconditional lifetime employment. Performance and skill was never praised in any form, opportunities for promotion or bonuses. In the post-Mao period, the situation varied in three of these fields. "Under the reform of the educational system announced in the spring of 1985, the content of the middle school curriculum in

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<sup>60</sup> Urban residents had received financial protection since the early 1950s by way of food subsidies and medical and social welfare facilities. The soaring prices were also the one reason behind the tragedy of June 1989.

<sup>61</sup> Harding, n. 41, p. 113.

the cities was altered to stress vocational training to provide a better match between the skills of the labour force and the demands of the industrial sector.”<sup>62</sup> Workers were allowed to change their job within the network of state enterprises. But the non-state sector’s employing capacity was increased and as a part of voluntary initiatives by state, workers seeking employment were allowed to apply for the jobs that they found attractive and to refuse assignments offered them by state labour bureau. The case of incentives to workers also drastically changed since enterprises were allowed to retain the profit, they (enterprises) started granting bonuses to deserving workers from the profits. “In late 1984, in its decision on urban economic reforms, the party announced that it is planning to develop measures that would ‘better link wages and bonuses with the improved enterprises performance’.”<sup>63</sup> This created an atmosphere for the fostering of economic development.

Among the urban economic reforms the most outstanding was the establishment of the Special Economic Zones (SEZ). Actually, the process of their establishment started with the Hua Guofeng’s initiatives. After the downfall of the Gang of Four, Hua Guofeng initiated a large-scale programme for importing western technology and equipment. Chinese decision-makers saw the advantages of zones to economic development <sup>64</sup> and the ideas of some sort

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<sup>62</sup> *ibid.* p. 117.

<sup>63</sup> *ibid.* p. 119.

<sup>64</sup> Prior to the 1978, Chinese officials regarded export promotion zones in many developing countries as a manifestation of contemporary imperialism and new colonialism.

of economic zones was brought in March 1979.<sup>65</sup> Deng, by allowing the establishment of SEZs, wished to set an example for others to emulate, and that's why some people and some regions were encouraged to get rich first. On 24th February 1984, Deng himself called it "A special economic zone is a medium for introducing technology, management and knowledge. It is also a window for our foreign policy. Through the SEZs we can import foreign technology, obtain knowledge and learn management."<sup>66</sup> The implementation of this policy, in real sense, opened the gates of new avenues to China's economy. The opening of SEZs made China not only to stand but also made it capable to compete with big powers in the world market. The policy of 'to open not to close'<sup>67</sup> through SEZs proved successful. "The coastal regions attracted 85 percent of foreign investment. The 120,000 foreign-funded companies employing nearly 10 percent of the urban work force accounted for 47 percent of the country's foreign trade. In Guangdong, the figure was 54 percent and in Tianjin as high as 70 percent."<sup>68</sup> Overall, the urban economy has been at the core of Deng's reform to enliven the economy at home and to open the country to foreign technology and trade.

#### **2.4.3. Opening of China to the outside World**

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<sup>65</sup> Wei-Wei Zhang, *Ideology and Economic Reform under Deng Xiaoping 1978-1993* (London, 1996), p. 76.

<sup>66</sup> Deng Xiaoping, "Make a success of Special Economic Zones and Open more cities to the outside world", *Selected works of Deng Xiaoping*, vol. II (1975-1982), from the website – [www.english.peoplesdaily.com.cn](http://www.english.peoplesdaily.com.cn)

<sup>67</sup> *ibid.*

<sup>68</sup> Jasper Becker, *The Chinese* (New York, 2000), p. 121.

China after the rapprochement with US (1971), started moving closer to the West, and its international isolation came to an end. Peking dramatically increased imports of industrial-supplies and foreign technology particularly for coal plants and expanded the exports of agricultural goods and raw materials. China began to open its market to the outside world in 1973. It was decided to revise its development strategy, end isolation, open up to the outside world, increase exports and raise the status of exporting industries. By 1975, the country's total foreign trade had reached nearly \$ 15 billion, an increase of more than 250 percent in only six years; and export rose to 5 percent of national output, the highest level in the history of the People's Republic.<sup>69</sup> But for the foreign ventures it was easy to do business in China. The continuing interference by the political elites started blocking the path of foreign investment. Under the prodding of the Gang of four, for example, Chinese leaders in the mid-1970s refused to accept foreign investment, foreign aid, or foreign loans. With the fall of Gang of four and the rise of reformists, the discussion to open China took place in the third plenum of 1978.

The Open door policy of the 1980s, which has become a prime source of innovation in the reform effort, would have been completely impracticable in the domestic context of the early 1960s. The contradiction within the communist bloc, and the failure of the development policy that was accepted by Chinese leaders proved hopeless. The idea of self-reliance, leaning to one side proved less compatible with the changing internal and external conditions, and as a

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<sup>69</sup> Harding, n. 41, p. 131.

result those were called 'faults'. Under socialism producing firms were forbidden from having direct contact with the outside world, that is, with foreign customers and suppliers. They could not engage directly in foreign trade, but must conduct such operations through the appropriate foreign corporations. In socialist countries, foreign trade corporations were given monopoly rights over the conduct of foreign trade in industry. The domestic industry was banned from taking, acquiring and applying of foreign technical know-how. The merging in to the world economy would have benefited the China's economy in different ways. Shirk argues that the reason for this change was that "Deng Xiaoping and his allies concluded that ...no country had ever achieved modernization by "closed doorism".<sup>70</sup> Deng warned that China should not adopt a closed door attitude and refuse to learn from the good things of foreign countries".<sup>71</sup>

The reform of 1978 focused on increasing China's interaction with international economy. Under China's pre-reform system the sectoral foreign corporations had taken all decisions about foreign trade. However, this system would be difficult to operate with a vastly enlarged foreign trade account. Greater authority was granted to ministries and to local-municipal governments so as to allow them to engage in foreign trade transactions. This system was further devolved in order to bring corporations, enterprises and factories in contact with foreign firms, presumably in the hope that this would expose them to the benefits of international comparative advantage and co-operation.

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<sup>70</sup> S. Shirk, (1993), quoted by David J. Pyle, *China's Economy* (London, 1997), p. 107.

<sup>71</sup> Harding, n. 41, p. 133.

Government started encouraging foreign trade companies to form joint operations with productive enterprises so that, for the first time a single organization became responsible for production and marketing.<sup>72</sup> The localities are allowed to retain a portion of the foreign exchange, which they earn through foreign trade. China increased its economic relations with other powers. Beijing started welcoming direct foreign investment. To justify their proposal and to welcome foreign investment in the country, Chinese leaders described it as a form of 'State Capitalism'.<sup>73</sup> They hoped these foreign entrepreneurs to play a constructive role in China's economic development. Loans were negotiated and foreign businessmen were encouraged to participate in joint investment enterprises in China. At first, cautious Chinese leaders intended to limit the scope of foreign investment in their country to particular organizational forms (the equity joint venture as the organizational format) and particular geographic regions (Four Special Economic Zones).<sup>74</sup> But these limitations were soon lifted, and now investment is welcomed in every sector of the economy and any part of the country. SEZs worked as a window for the foreign investor to come in. Beijing designated certain part of the country first, four special economic zones in the southeast, then fourteen 'open cities' and Hainan island, and three 'larger development zones' along the southern coast to be front runners in absorbing foreign technology, introducing foreign capital and expanding Chinese exports.

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<sup>72</sup> Harding, n. 41, p. 137

<sup>73</sup> *ibid.*, p. 159.

<sup>74</sup> *ibid.*

to foreign markets.<sup>75</sup> China's efforts to open up its economy to the world have been a more successful than most people expected when the open door policy was first unveiled. Large amount of foreign investment foreign investment is pouring into the mainland, particularly into the coastal regions and special economic zones. The resulting business ventures have enabled overseas Chinese investors to exploit their comparative advantages in technology, entrepreneurial ability, and culture. As a result, peoples are enjoying dramatic increases in wages and standard of living.

## Conclusion

The second revolution waged by Deng Xiaoping is still going on. Throughout this chapter it is discussed that the achievements made by the second-generation leaders under the leadership of Deng Xiaoping are far greater than of Mao's period. After two decades, the priorities of the reforms are evenly settled and each sector is allowed to develop with enough space of freedom. The problems like corruption, inflation, trade deficits, and the growing economic insecurity are still haunting the development. The revolution is mostly threatened by the restructuring of the state-owned enterprises. With the

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<sup>75</sup> China designated four areas along the southeast coast – Shenzhen, Zhuhai, Xiamen, and Shantou – as special Economic Zones in 1979.

“By middle of 1986, some more areas were created to attract foreign investment. Three development triangles in South-eastern and central China – The Pearl river, Min river, and Yangtze river deltas had been identified and trade and investment promotion zones. These regions were expected to do the same job, which SEZs were doing. Like the SEZs, these regions are a base for exports and a filter to digest the World's modern science and technology and advanced managerial methods... so as to discard the dross and select the essential.”

(*Banyuetan*, no.4, Feb. 25, 1985 quoted by Harding, n. 41, p. 167).

accepting of market-economy, state tried to achieve more economic strength, but vice-versa the measures to reform economic model along with the development have caused pain for state employees. Economic strengthening of the state proved economic instability for workers. The Restructuring of the state-owned enterprises according to the market norms have certainly helped Chinese economy to get rid of the existing evils in the economy, but the future of China's economic development depends on the restructuring of the SOEs.



## **Chapter 3**

# **Restructuring of the State-owned Enterprises**

## Chapter 3

### Restructuring of the State-owned Enterprises

#### 3.1. Introduction

All the major industries in China are owned by the state, controlled by the state, and dependent upon the state. Hundreds of million of Chinese are reported to work in these state-owned enterprises, producing a wide variety of mainly industrial goods. Beginning in 1978 with Deng Xiaoping's rise to power, Chinese economy witnessed a growth spurt with innovations in the SOEs. Under the name of collective ownership, Chinese state controls the state-owned enterprises. These economic institutions worked for the fulfilment of political, social and economic goals. These enterprises occupied an important place in the People's Republic of China's economic experiments during post-49 period. In the early days of a nation building, the role of the SOEs was critical. All round inefficiency and the need to shift from soviet-style extensive growth to intensive growth based on improved resource allocation contributed to the emergence of Chinese economic reforms in the late 1970s. The fundamental weakness had been inefficient use of labour, capital, energy and raw materials and a mismatch between the composition and quality production and demand. In December 1978, the third plenary session of the Eleventh Party Congress adopted a new programme of adjustment and reform.<sup>1</sup> The quest to increase the pace of

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<sup>1</sup> Tidrik Gene (*China's Industrial Reform*) has explained the need of adjustments,

economic development, it became very necessary to take strong measures. Soon the state of SOEs turned into a bone of contention between the state and workers. A number of steps were taken to revitalize the enterprises. Given the nature of and role of SOEs in China's economic development the situation became too complex and a thorough restructuring process of the enterprises is not complete as yet.

This is ironical that even after the commencement of economic reforms, the condition of these enterprises has deteriorated. After 1978, market based managerial relations have been created throughout the SOE sector, transforming China's industrial sector market oriented. The following discussion reviews reforms and structural changes in regards to SOEs, and highlights some important achievements and problems.

### **3.2 State-owned Enterprises in the Pre-reform period:**

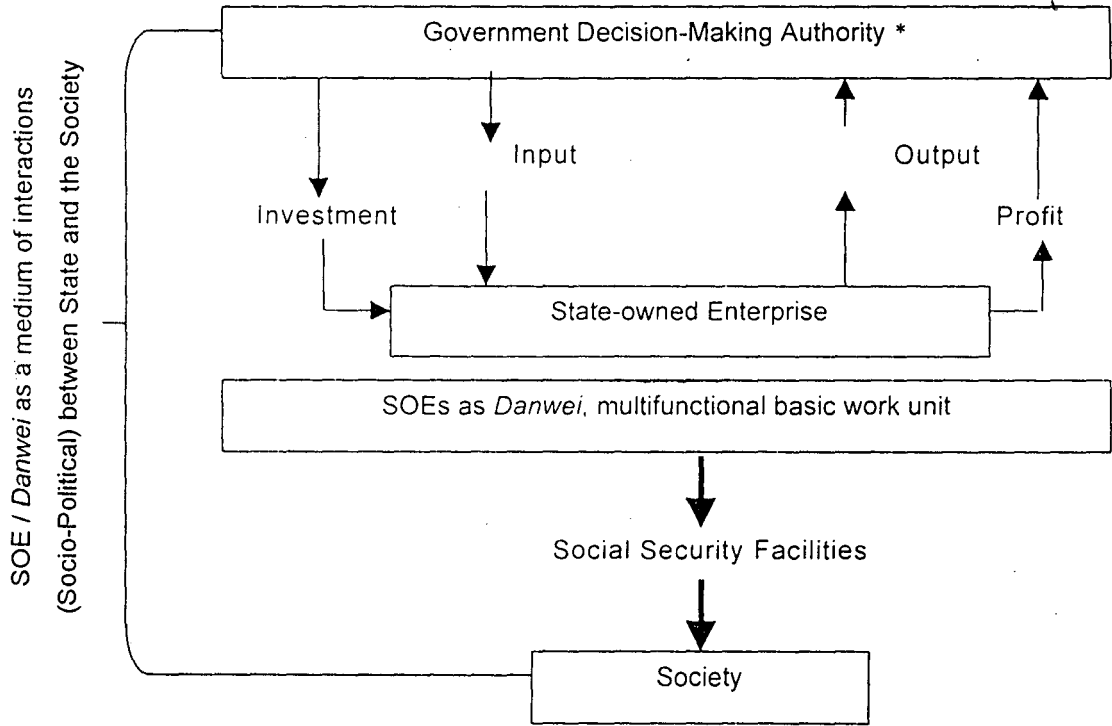
The nature of the state-owned enterprise in Mao's era was too complex. The SOEs were merely a production unit, and more than that those were engaged in providing social stability through the role of social security provider, and moreover, it was used as a tool to strengthen the party's rule. The roles of the SOEs were immensely intermingled with each other. It is very necessary to understand the nature of these institutions in the pre-reform period. There are

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Adjustment was to achieve five main objectives. First, it would reverse the traditional order to priority given to heavy industry, light industry, and agriculture. Second, it would increase the share of consumption in national income. Third, it would reduce the consumption of energy. Fourth, it would increase exports, especially of manufactured goods. Fifth, it would emphasis plant

three shades of SOEs' performance in the pre-reform period i.e. political dimension, economic dimension and the social dimension.

Figure 3.1  
**Diagrammatic Presentation of the Role of State-owned Enterprise in the Command Economy**



Note: \* Government decision making authorities were stratified according to the Administrative hierarchy, and those were

- Central Government agencies
- Provisional Government agencies
- Local Government agencies.

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modernization and improved efficiency in existing enterprises rather than economic development

SOEs were used to play the political role. It was a medium to establish the state control through all over the China. The institutions like *Danwei* were created to spread the ideological seeds. Chinese leadership used decentralization as an instrument to put central policy into effect under local conditions more swiftly and intelligently.<sup>2</sup> But the control over the profits of these decentralized state-enterprises remained with the central government, in the name of socialism, government could control the economic nerves of the country, this was a big political step. For the first time, social security decision-making power was passed on to the single *Danwei*,<sup>3</sup> the State-owned Enterprise as the care-taking system. Central government had a firm grip on the *danwei* as a unit delegating the important tasks of social control and implementation of central policies. Under the *danwei* system, individual initiative, autonomy of social organizations and market mechanism were non-existent. The vertical chain of state administrative power from the top to the grass roots brought every *danwei* and thus every individual, through his *danwei*, under state and party control.<sup>4</sup> The control on SOEs was 'systemic'<sup>5</sup> and was often supported as an effort to consolidate the party's rule. Thomas Rawski explained this phenomenon as, "the chief obligation of the firm, and of the managers and party personnel occupying

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through new capital construction

<sup>2</sup> Manfred F. Romich, "Decentralization and the Danwei system: Economic Reform and its Impact on Social Development in Chinese cities", in *China Report* (New Delhi), vol.30, no.4, October-December 1994, pp. 447-56.

<sup>3</sup> The *Danwei* constitutes the basic unit of the contemporary Chinese society.

<sup>4</sup> Romich, n.2, pp.447-56

<sup>5</sup> In the post-49 period, the establishment of the Government control over SOEs was generalized under the rule of law. The phenomenon was so frequent that later, it became less objectionable and widely

key post, is to carry out annual economic plans issued by the State Council and other organs of the central government.”<sup>6</sup> The *danwei* net spread over the enterprises helped the state to reach the bottom level of the system. Ideologically speaking, the state was engaged in socializing people politically by controlling enterprises. The state-owned enterprises worked for political integration and further education. Under the planned economy, state-owned enterprises played a very important role in the interaction between the state and members of society.

Along with the political performance, the SOEs also performed as a basic economic unit to strengthen country’s financial health. Before 1979, China’s SOEs were typical production units in a central planning economy. The interlocked market system eroded the vitality of enterprises. Since the profit retention and incentives were out of thought, the functions of the enterprises were too technical, which also caused stagnation of innovative ideas. “Despite periodic changes in the list of norms and in their relative importance, plan targets have always included figures of sales value and physical output of major commodities, financial quotas involving wages, costs, and profit, and subsidiary requirements concerning input coefficients, research, and innovation.”<sup>7</sup> SOEs transferred all their surplus funds to the state budget and relied on the state for subsidies to cover losses and grants for investment. The investment and working

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acceptable. In spite of having independent economic entity, it was overshadowed by Government control and became part of that machinery.

<sup>6</sup> Thomas G. Rawski, “China’s Industrial system”, in U.S. Congress, Joint Economic Committee (ed.), *China: A Re-assessment of the Economy*, July 10 (Washington D.C.: US Government Printing Office, 1975) Reproduced in Joseph C.H. Chai, (ed.), *The Economic Development of Modern China: Socialist Modernization 1949-1978* (Vol. II) (Cheltenham, 2000), pp.112-135.

<sup>7</sup> Rawski, n.6, pp.112-135.

capital were mostly financed through the grants provided from the government budget or loans from the banking system according to the government plans.<sup>8</sup> Under this system, SOEs had an extremely limited autonomy in decision-making, in the realm of setting prices and deciding investment priorities.

The SOEs had a social face too. State-owned enterprises, as a guarantor of social security, worked as an institution of control. As the researcher mentioned earlier that SOEs in Mainland China operated as a working unit, *danwei*. These *danwei* was supposed to integrate social functions.<sup>9</sup> By absorbing almost all social functions the *danwei* controlled the distribution of resources among its members. The centre was not capable of providing such facilities directly to the people, since it was a kind of centralized state. By allocating, state-owned enterprises or *danweis* to perform a function of a guarantor, centre bifurcated the responsibility of providing social security to its citizens. The concept like 'eating from a big pot', 'Iron rice bowl' emerged from a system of providing basic amenities to the common Chinese. The *danwei* had controlled the distribution of food and consumer goods.<sup>10</sup> From a social perspective, the enterprises had become 'cells of society', or 'small societies within themselves', and for many people, apart from their immediate families, they are the only social institutions that they knew. Childcare, pensions, education and health care

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<sup>8</sup> Qimiao Fan and Peter Nolan (eds.), *China Economic Reforms: The Costs and Benefits of Incrementalism* (New York, 1994), p.139.

<sup>9</sup> Romich, n.2, pp. 447-456.

<sup>10</sup> *ibid.*

were organized and provided by these *danweis*. This encouraged the phenomena of an enterprise run society.<sup>11</sup>

### **3.3. The Problem: The State-owned Enterprises, an epicentre of Economic imbalance**

Soon after the establishment of PRC the lack of infrastructure and the entrepreneurship had posed a big problem for the Chinese economy, under the direction of CCP the experiment with Soviet structure in China was chosen for the further development process. The SOEs proved successful in producing vast quantities of infrastructural commodities such as iron, steel, coal of which China became the world's biggest producer. To make SOEs an efficient economic institution Mao had applied some of the Japanese management measures to the Chinese economy, like 'raise rational suggestions' (*ti hei hua jianyi*) or the *danwei* system that was familiar to the Japanese 'work place family system'. But these steps have not yielded the desired results.

The so-called achieved progress was achieved in the face of disregard for quality or cost. Subjugation to the interests of the party-state meant that industrial enterprises under Mao were run by party fiat, which discouraged the managers in the government-owned enterprises. Managers were forced to focus on numerical measures of output rather than on quality or customer needs, which

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<sup>11</sup> The term like 'Cells of Society', 'Small societies within themselves', 'Enterprise-run Society' have been exclusively taken from the work done by Chien - Min Chao and Bruce J. Dickson (eds.), *Remaking the Chinese State: Strategies, Society, and Security* (London, 2001), pp. 221-238.



made large-scale production of inferior goods that could not be sold outside the country. Politically, these institutions were conserved and allowed to perform social role in the country, but it was done at the cost of economic efficiency.

The problem was deep-rooted; in 1978 some measures (this will be discussed in the next section) were taken to cure the problem. But those proved insufficient. The foreign investment, for which, the doors were widely opened, with the other gradualist economic policies, played an extremely large role in this. Before the investment came, only the state could control large industries. Competitions within the boundaries of China were low. The opening brought new foreign ventures to the country. This was how the state started losing its control over the domestic market. With the increasing FDI, private and joint ventures flourished in China. This new sector was never heard of during the pre-reform period. This sector later with the help of improved management skills and sophisticated technology started competing with SOEs and eventually this led to complications within the economic structure of China, resulting in the failure of SOEs. The SOE sector remained the dominant in China's economy. It consumes about 70 percent of the total labour and capital employed in Chinese industry. However, the SOE sector only generates about 40 percent of the output.<sup>12</sup> This signifies the inefficiency of the SOE management. Factories failed to adopt more contemporary technology as a result of the problems of relative

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<sup>12</sup> Satya J. Gabriel, "Restructuring State-owned Enterprises in China" at <http://www.mtholyoke.edu/courses/>

inefficiency grew higher. Too much of government control led to a slow paced transformation of SOEs “Because of the highly hierarchical structure and parallel jurisdiction decision-making was often slow and inflexible.”<sup>13</sup> Therefore, the “enterprises were inhibited from responding quickly to the changing market and technological conditions”<sup>14</sup> as a result, in 1978, Sichuan Chengdu Measuring and Cutting Tool Plant, then desperately in need of a special machine tools went through more than 10 administrative bureau with its request and wasted two years to no avail.<sup>15</sup> This happened because of the culture of ‘subordination to many administrative supervisors’. “An enterprise was very often subject to many immediate superiors. It often received targets not only from its parent bureau, that is, the respective industrial bureau or corporation, but also from specialized supporting functional bureau.”<sup>16</sup> For example, the finance bureau in charge of a group of enterprises, for financing, always directed the management of particular enterprise. The enterprises were obliged for clearance by industrial bureau and financial bureau. With this every small process became time consuming. The hierarchy of command became blurred. Due to the various influencing agencies and their varied interests, the proper coordination was lacked. Carelessness of responsibility created problem like inconsistency and inflexibility in the enterprises.

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<sup>13</sup> Joseph C. H. Chai, *China: Transition to a Market Economy* (Oxford, 1997), p. 34.

<sup>14</sup> *ibid.*

<sup>15</sup> Liu Guoguang (ed.) *Theoretical Issues in National Economic System Reform* (Beijing, 1980), p. 59, Cited in Chai, n. 23, p. 34.

<sup>16</sup> Chai, n. 13, p. 34.

The Chinese economic growth is in full swing, per capita income has increased more than four fold, and millions have moved from the dying state sector to the vibrant non-state sector. But the serious problem remains unresolved, especially in the financial service industry. The four large state banks continue to monopolize the allocation of scarce capital and restrict the flow of funds going to the non-state sector. Political factor, not efficiency and profitability, largely determines who gets the available funds. Indeed, SOEs receive more than two-thirds of the funds but account for less than one-third of industrial output value. The inefficiency of SOEs has created a problem for state-owned banks. "The central government poured more than 80 percent of the states banks' financial assets into SOEs to encourage growth. This was regarded as socially and politically essential."<sup>17</sup> Most of the banks are technically bankrupt. "These banks hold non-performing loans, as much as 25 per cent or more of all loans, that is why recapitalizing the banks is not a panacea. Cheaper credit will flow to favour SOEs that will waste scare capital on low quality pet projects that have little net value to consumers."<sup>18</sup> The total undermining of the entire banking system by the state allowed SOEs to be a devastating drain on the resources of the state. "Financial information has been so corrupted that neither firms nor banks nor anyone else knows the true financial health of borrower or lenders."<sup>19</sup> This kind of favouritism

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<sup>17</sup> *Strategic Comments*, n. 27.

<sup>18</sup> James Dorn, "State-owned Enterprises continue to hinder Chinese growth" at <http://www.freetrade.org/pubs/articles/>

<sup>19</sup> Elizabeth C. Economy, "Reforming China", in *Survival* (Oxford), vol. 41, n. 3, Autumn 1999, pp. 21-42.

in the financial system has been causing havoc for the long-term growth.<sup>20</sup> The feeding of loss-making SOEs is an open secret.

The health care facilities, housing, medical care, pensions provided to the employees were always defended in the name of social welfare system and funds were made available to these requirements. To some extent these practices are justifiable. The over-burden of expenses was enough to show the 'rational necessity' of restructuring. The surplus expenditure cannot be justifiable in the case where profits are possible. Bringing down the subsidy rate was a necessary part. The over concentration on the SOEs has led to the negligence of aspects relating to the society and the economy. The rural sector policies were treated subordinate to the industrial policies concerned with the urban areas. So the urban area, which was closely related to the enterprises and state-owned industry, was enjoying benefits more than rural area. "Subsidies for urban industry can also be seen as a massive transfer of resources from the countryside, where the large share of population resides. This shift deprived the rural economy, and especially the poorer interior provinces, of many of the benefits of economic growth, despite the fact that agriculture powered much of the economy's development."<sup>21</sup>

In China, during the reform years, the agriculture was paid little attention than the industrial sector of the country. The surety of economic security often

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<sup>20</sup> Because the Bank savings have been moving from high-growth sectors to low-growth sectors, which is unnecessarily affecting the mode of development.

varied from village to town. Since the state was engaged in paying more attention to state-owned enterprises, its subsidies and social facilities to SOEs employees, the job atmosphere and economic security made bulk of population to leave villages and agriculture and to migrate to urban areas.

Corruption, one of the most inseparable parts of the China's economy was also the result of the centralized economy. CCP's interest and the nepotism created by high-ranking party members in the industries changed the social face of state enterprises. People's Liberation Army was also in front to grab the opportunity. This state proposed a-political body established its links through various managements of SOEs. The monopolization of state-owned industries by CCP and PLA gave birth to red-tapism and corruption in the recent period and still the phenomenon continues. "About 400 PLA pharmaceutical companies produce 10 percent of China's drugs, and army's factories make about 20 percent of its cars, trucks and half of its motorcycles."<sup>22</sup> An involvement of these influencing bodies in some of the businesses of enterprises made it compulsory for state to provide funds and infrastructure facilities to firms without any consideration, which was also one of the reasons behind the collapse of the China's financial system.

With regard to technological and managerial aspects, the SOEs lacked credible strategies. In the industrial sector these are the two important variables,

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<sup>21</sup> *Strategic Comments* (Indian Institute for Strategic Studies), "The End of China's Era of Growth", in *The Hindu* (Hyderabad), 9<sup>th</sup> March 1999.

which make the success easy. The caged managerial activities were not efficient and authorized to adopt such steps. Due to the lack of freedom at managerial level and constraints over importing new technology, the SOEs were transformed to technically functioning industrial unit. Since the boundaries of managerial functions were outlined by the state, enterprises could not come up with new ideas. Enterprise runners never felt possessive about their enterprises. Even in the Maoist era, as discussed earlier, the introduction of Chinese version of Japanese style of democratic participation in enterprises failed. According to this system “workers were asked to ‘raise rational suggestion’ (*ti hei hua jianyi*) yet these Chinese practices became formalistic rituals, and never achieved the results intended.”<sup>23</sup> The value of worker and their hidden entrepreneurial qualities were never recognized. This was the prime reason that made the managerial activities passive, which in turn affected the performance of enterprises turning them into loss-making enterprises. Moreover, the authoritarian control of the enterprises crushed the innovative mindset of workers.

The increasingly poor performance of the SOEs has sent ripples throughout the entire Chinese economy affecting every other facet of the developmental process. The inter connection of debts, losses among state enterprises also contributed to worsen the condition more. Since, the enterprises

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<sup>22</sup> M.V.Rappai, “The PLA (People’s Liberation Army) sheds its business interests”, in *The Hindu* (Hyderabad), 10<sup>th</sup> February 1999.

<sup>23</sup> Barrett, L. McCormick and Jonathan Unger (eds.), *China Under Socialism: In the Footsteps of Eastern Europe or East Asia* (New York, 1996), p. 190.

were allowed or some times made to lend capital to other SOEs, the chain of indebted enterprises grew. This created a line of sunken enterprises. Even lending was not refused; it was necessary to keep enterprises in working mode. Along with this, “the lack of cooperation and specialization between enterprises”<sup>24</sup> highlighted China’s industrial administrative structure. The property rights over the enterprises were distributed to different supervising administrative units. So these units had control over the enterprises, starting from decision-making, to income rights, and to share the revenues generated by the enterprise. The sense of ‘belonging’ towards the enterprises created “a favourable environment for the breeding of departmentalism, localism, and autarky.”<sup>25</sup> The emergence of localism or departmentalism signified itself in dysfunctional behaviour on the part of the administrative units that aimed at maximizing their own group interests at the expense of social interests. “Autarky resulted from departmentalism or localism in combination with that planning... it was a result of the weakness of Chinese central planning which was under constant attack by Maoist ideologues. Autarky resulted in duplicate investment and production.”<sup>26</sup> Liu Guoguang says that most of the factories produced commodities for the use of their own administrative units.<sup>27</sup> So the reality always varied from that of the doctored data.

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<sup>24</sup> Chai, n.13, p. 35.

<sup>25</sup> *ibid.*

<sup>26</sup> *ibid.*

<sup>27</sup> Guoguang (1980), p. 3. Cited in Chai, n. 13, p. 36.

For these reasons it is apt to call SOE as the epicentre of all the economic tremors, which Chinese economy faced. The rebuilding of the economy was necessary by taking appropriate steps to avoid further mal-practices, which would lead the progress of other sectors of economy.

### **3.4. The Solution: Restructuring of the State-owned Enterprises.**

The restructuring of the state-owned enterprises was the only way out to this problem. Of course, the restructuring was the result of many reasons. The opening of China provided an option without any delay, along with, the emergence of reformist or revisionist line. The emergence of Deng Xiaoping accelerated this transformation. "The impetus for enterprises reform derived from a combination of genuine problems in the economy, the open intellectual atmosphere that prevailed in the wake of the campaign for 'practice as the sole criterion of truth',<sup>28</sup> and the competition for political power."<sup>29</sup> The tussles between the radicals (Status Quoists) and reformist fostered the discussions of the restructuring of the economy and restructuring of the state enterprises as well. State by accepting the way of restructuring, aimed to increase the efficiency and performance of the SOEs to face the challenges. In the process of restructuring state had various options viz. gradually withdrawing and relaxing control, revitalizing SOEs through reorganization, association, merger, leasing,

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<sup>28</sup> After the end of the Cultural Revolution, many of the Chinese intellectuals, who had fled out, came back to the country. The establishment of the Chinese Academy of Social Sciences further fostered the unprecedented openness.

<sup>29</sup> Joseph Fewsmith, *Dilemmas of Reform in China: Political Conflict and Economic Debate* (New York, 1994), p. 57.



contract operation, joint stock partnership and outright sale. The decision to open the economy and other economic restructuring was not decided over a night. The evolution of the restructuring concept is very necessary before studying the enterprise and reform in particular.

In 1975, Zhao Ziyang was appointed as the first secretary of the party to the Sichuan province.<sup>30</sup> Zhao Ziyang was known as the reformist, he took a personal interest in the research activities of the Sichuan Academy of Social Sciences. In the year 1977, Zhao with Hua Guofeng went to the Eastern Europe and there he was impressed by Yugoslavia's experiment with self-managing enterprises. And this left a deep impact on Zhao's thinking. Zhao decided to implement these policies in Sichuan as an innovation to the already existing situation.<sup>31</sup> "These experiments got underway in the fourth quarter of 1978, when the Sichuan provincial government granted expanded authority to six enterprises. At the time, the experiments were quite limited. Profit targets were fixed, and the factories were allowed to keep a certain amount of their profits above their quotas."<sup>32</sup> The results of these early experiments in the enterprises proved helpful for leadership to get the feedback.

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<sup>30</sup> He became the Premier of the People's Republic of China from 1980 to 1987 and the General Secretary of the Chinese Communist Party from 1987 to 1989. Zhao Ziyang was the leading Dengist reformer in post-Mao China.

<sup>31</sup> In 1975, when Sichuan province was in agricultural difficulties, Zhao was reassigned as a governor and party leader there with full authority. In Sichuan, Zhao made his reputation as a daring innovator who disbanded Mao's Commune system. He personally visited the fields to inspire farmers to work for their own material betterment. His effort resulted in a miraculous increase in agricultural productivity. The prosperity of Sichuan's rural population earned Zhao nationwide reputation.

<sup>32</sup> Fewsmith, n.29, p.56.

During the same period, in China, the discussion about the enterprise restructuring was going on simultaneously. At the political level, the need of restructuring process was felt necessary. The Wuxi conference, and the role played by Yu Qiuli, Hu Xiaomu and Xue Muqiao proved significant in deciding the enterprise reforms, which had focused on the restructuring process.

The 'Petroleum group' guided by Yu Qiuli, was a powerful economic and political centre in the pre-1978 China. "The petroleum group was composed of officials who had made their careers and rose to the top of the Chinese political system through their development of China's petroleum industry, particularly the Daqing oil field."<sup>33</sup> During the 1960s when the intensive efforts to explore new oil fields started, the then Minister of Petroleum, Yu Qiuli, had moved to Daqing, where he undertook efforts of direct development of its oil fields. In 1964, Mao invited Yu Qiuli, and his associates to draw up plans for a faster development in the interior of China- the so-called third front. But the plans drawn by Yu could not be implemented.<sup>34</sup> After the rise of Deng in 1978, the petroleum group again came to fore front. The policies like import of foreign technology and equipment were given attention along with the suggestions made by Chen Yun,<sup>35</sup> viz. expansion of market forces in the economy, greater autonomy for enterprises, and the restoration of 'balance' in the economy

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<sup>33</sup> *ibid.*, p. 57.

<sup>34</sup> Since Yu Qiuli advocated the need of import of foreign technology and equipment, he came under sharp criticism in the early part of the Cultural Revolution. Those reform policies were called as 'three poisonous weeds' and were criticized for 'selling out' the interests of China.

<sup>35</sup> During 1960s the policies for the Third Five Year Plan were drawn under the supervision of Chen Yun. With the change in the time Mao felt those policies, which were envisioned, as less interesting.

through a policy of 'readjustment'. The genealogy of the enterprise reforms can be traced back to the Hu Qiaomu's well-known report to the State Council in July 1978, entitled 'Act in accordance with economic laws', stepped up the four modernizations. The report functioned as a 'catalyst' to generate debates across the country. These discussions and talks concentrated on the issues related to reform particularly to the 'law of value'. These meetings culminated in the Wuxi conference, held in April 1979. "At the Wuxi conference, theorists from the State Planning Commission's Economic Research Office, the State Statistical Bureau, and Chinese Academic of Social Sciences (CASS) attacked the planning system as it had existed in China over the prior three decades. The crux of their critique was that the planning system over concentrated authority in the party and shifted excessively stifling the initiative of enterprises. The result was that enterprises produced for the plan, not for market needs, so that unneeded products piled up in ware houses while needed goods were not produced."<sup>36</sup> The Wuxi conference emphasized on the blend of both plan and market and at the same time concentrated on the enterprise reforms.

The systematic criticism of orthodox Marxist economy was the main feature of the Wuxi conference. During the same period, another intellectual Xue Muqiao's<sup>37</sup> work *Studies on China's Socialist Economy*, underpinned the Dengist reforms. The book was an effort to articulate a theory of socialist

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<sup>36</sup> Fewsmith, n. 29, pp. 64-65.

<sup>37</sup> Xue had been Vice Minister of the State Planning Commission and Head of the State Statistical Bureau in the 1950s. Later, following the arrest of the Gang of Four, he was appointed as an advisor to the Economic Research Office (*Jianji yanjiu suo*) of the State Planning Commission.

economics in the most systematic and authoritative manner.<sup>38</sup> Xue condemned the Cultural Revolution period because it undermined the plans and the economy. The economy was more or less made anarchic. Xue argued in favour of increasing both planned management and the decision-making authority of localities and enterprises.<sup>39</sup>

These developments regarding the restructuring of economy served the way for the commencement of reform era. The main thrust of these happenings was to stress the importance on the redefining of state-enterprise relations and the more autonomous sphere to the state enterprises. “The Wuxi conference and Xue Muqiao’s book marked important efforts at a systematic conceptualisation of what was wrong with China’s economic management system and the direction in which the reform programme should go. In this sense they can be taken as the political-intellectual baseline from which economic reform proceeded”,<sup>40</sup> meanwhile the restructuring progressed in stages.

#### **3.4.1. The Stages of Restructuring**

The efforts to restructure the SOEs took place in a phased manner. The phases were not planned and demarcated, but to study the complex phenomena it is necessary to divide it into different periods. The restructuring efforts that took place during the period 1978 to up to date can be divided in to following periods:

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<sup>38</sup> *ibid.*, p. 68.

<sup>39</sup> *ibid.*, pp. 68-69.

<sup>40</sup> *ibid.*, p. 70.

### 3.4.1.1. First stage (1978-1983)

The increasing costs of industrial growth prompted the Chinese government to decentralize decision-making in China's state industrial system in the late 1970s. The decision to decentralize was initiated at the third plenary session of the 11<sup>th</sup> central committee of the Chinese Communist Party (CCP) held in late 1978. "This initial stage focused on increasing the operational autonomy accorded to enterprises managers, largely by allowing them greatly increased authority over the allocation of their profits."<sup>41</sup> The experiments were conducted in Sichuan province where six provinces were chosen for this. In 1979, it was extended to the whole country. During the time of experiment the behaviour of authorities and the functioning of the enterprise are closely scrutinized and based on the feedback received by the state, the State Council accelerated the pace of issuing more decrees widening the independent managerial authority of the state-owned enterprises.<sup>42</sup> The gist of the policies can be summarized as follows:

- 1) Greater decision-making autonomy for enterprises in production and to a lesser extent in investment,

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<sup>41</sup> Nicholas R. Lardy, *China's Unfinished Economic Revolution* (Washington D.C., 1998), p. 22.

<sup>42</sup> During this time, the regulations issued by the state council were as follows:

(a) 'Several Rules concerning the Expansion of Managerial and Marketing Autonomy in State-owned Industrial Enterprises'; (b) 'The Regulation on Profit Retention in State-owned Enterprises'; (c) 'The Provincial Regulation on a Fixed-assets Tax in State-owned Enterprises'; (d) 'The Regulation on the Increase in the Depreciation rate and Improvement in the Use of Depreciation Funds in State-owned Enterprises'; (e) 'The Provisional Regulation Concerning the Use of Bank Loans for the Total Amount of Working Capital in State-owned Enterprises'. See, Qimiao Fan and Peter Nolan, (eds.), *China's Economic Reforms: The costs and the Benefits of Incrementalism* (London, 1994), p. 154.

- 2) Reinstitution of financial incentives for enterprises and individuals,
- 3) Expansion of the role of market in the allocation of industrial goods and corresponding reductions in the role of planning and administrative allocation,
- 4) Enterprises were allowed to retain profits at a fixed proportion of total profits determined by the Ministry of Finance and Local finance Bureaux;
- 5) Enterprises, after fulfilling their production quotas, were allowed to produce extra-plan products;
- 6) Enterprises were required to pay a charge on their fixed assets;
- 7) Working capital financed by bank loans rather than by grants from the Ministry of Finance and Local Finance Bureaux.

“By the end of the first half of the 1980, over 6,000 enterprises, comprising 15 percent of China’s 42,000 industrial enterprises were following the above instructions. These 6,000 enterprises accounted for 60 percent of the gross output value, and 70 percent of the profits of China’s key industrial enterprises.”<sup>43</sup> The firms were allowed to decide their fate in the decentralized, semi-market transactions. According to this the rules communicated to the enterprises from above were remitted, which automatically increased the level of discretion enjoyed by the enterprises. Earlier enterprises had to work according to the index of number of product groups and the index of the number and detail of obligatory targets. “Measured in terms of the first index Chinese state

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<sup>43</sup> *China’s Industrial Economic Management*, 1983, p. 184. Cited in Chai, n. 13, pp. 51-52.

industrial enterprises gained increased discretion in output decisions as both the number of products and the shares of industrial output subject to mandatory planning were substantially reduced. The former fell from 120 in 1979 to 60 in 1987 and the latter declined from 40 percent in 1984 to 17 percent in 1987.”<sup>44</sup> Earlier, funds allocation to the enterprises was linked to the fulfilment of some requirements, such as, output, quality, variety, and profit, together with delivery contract. The fulfilment of these would affect the rate at which an enterprise was able to subtract monies for the enterprise funds.”<sup>45</sup> But after the commencement of reforms, the enterprise fund system was replaced by the profit retention scheme. This reduced the number of earlier plan targets. The price reform during these first five years was significant. During this stage, reform measures centred on improvements in cost calculations and on the adjustment of controlled prices. The objective of the reform was to make controlled prices reflect more closely the actual costs of production.

The industrial hierarchy was rearranged to cut the administrative costs and to accommodate the increased liberalization and marketization of the economy. Flattening of the industrial hierarchy concentrated on the elimination of intermediate administrative units, namely the industrial ministries or bureaux and their main departments. An idea of placing enterprises directly under the administration of a single body, namely the Economic Commission was

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<sup>44</sup> Mengan Xie and Yuanmin Luo, *China's Economic Development During Last 40 years* (Beijing, 1990), p.45, Cited in Chai, n. 13, p.53.

<sup>45</sup> Chai, n.13, p. 53.

accepted, which was supposed to replace the old four level hierarchy (economic planning commission, ministries, departments and enterprises). The simplification carried out through following ways:

1. The reduction of the number of units at the bottom of the industrial hierarchy; 2. The formation of branch associations; 3. The reduction of the number of levels in the hierarchy and 4. The transfer of the functions of detailed supervision of enterprises from the top government economic organs to the branch administration.<sup>46</sup> The reforms, which took place in the late 1970s, and early 1980s were prepared and implemented at a very macro-level. With more experience, the conscious advance planning headed with micro-level reforms introduced in the next stage.

#### **3.4.1.2. Second stage, 1984-1989**

The economic package issued during earlier years generated a need for certain related reforms. Price reforms were needed (more sophisticated than the earlier introduced, see p. no. 97) so that market prices would reflect scarcity values in the economy. Reform in the system for determining wages, bonuses and labour allocation were required to provide credible incentives to workers. As a response to these, two significant reforms, Price reform and Contract Responsibility System (CRS) were adopted. Under the Price reforms, the focus was on price decontrol. The decontrol of prices in the industrial producer goods sector featured the dual price system under which two sets of process - fixed and



uncontrolled market prices - co-existed for the same product. In 1984, State Council allowed enterprises to enter into market with their own surplus output over and above the mandatory quotas at prices within the 20 percent limit fixed by the state. Later in 1985, the limit of 20 percent was removed and since then most industrial producer goods were sold fewer than two prices.<sup>47</sup> "Dual pricing divided supplies of industrial products into plan and market components. Under the dual pricing regime, most state enterprises transacted marginal sales and purchases and markets where prices responded increasingly to the forces of supply and demand."<sup>48</sup> The objective of the contract system was to increase productivity within the framework of continued state ownership by further separating the ownership of assets by the state from the management of the enterprises. The contracts were made mainly between state and various (state as well as collective) enterprises. Under this system, the duration of the contracts varies from three to five years. Later, with the consultation and after fixing the amount payable to the state, the contracts are finalized. During the contract period the enterprises would guarantee the state three things; (1) obligatory delivery of a certain amount of profit; (2) completion of the planned tasks of

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<sup>46</sup> *ibid.*, p. 36.

<sup>47</sup> The gap between market and fixed prices for selected producer goods became quite large. With the market price being higher than the fixed price. Later, efforts were made to correct the dysfunctional mechanism by imposing a ceiling on market prices, an upward adjustment of the state fixed prices (an upward adjustment was, under which the fixed prices of crude oil, coal, steel products, ferrous and non-ferrous metals, chemical industrial raw materials, plate glass and cotton textiles were adjusted upwards by 10 to 40 percent) and attempt was also made to eliminate the dual price system altogether by phasing out the fixed prices through decontrol of the prices of most industrial producer goods)

(China's Price Yearbook, 1989, p.144, and China Price, 1990, p. 37) Cited in Chai, n.13, p. 99.

<sup>48</sup> Gary H. Jefferson and Thomas G Rawski, "Enterprise Reform in Chinese Industry", in *Journal of Economic Perspectives*, 8 (2), Spring, 1994, pp. 47-70.

technical renovation of the enterprise, and (3) the link-up of the growth of its wage bill with that of its efficiency indicators. The state on the other hand held out the promise that the enterprises could retain any profit over and above the obligatory delivery.<sup>49</sup>

During this period smaller state and urban collective enterprises instituted more radical measures. Small firms were sold outright to individuals, others to their workers or a group of employees. Another practice like 'leasing' became widely accepted. In this arrangement the lessee typically paid a fee to the government and was allowed to keep most of the financial proceeds from improved performance during the lease period.

The government attempted at reducing the burden by bringing certain structural changes in the SOEs. "Pensions of state enterprise employee, which had been paid directly by their employers, were pooled at the municipal level.... Efforts to reduce the responsibility of enterprise for the heavily subsidized housing system also got under way slowly."<sup>50</sup>

Fureng Dong argued that surveys of state-owned enterprises, covering the period from 1980 to 1989, show that the share of material inputs purchased through the market rose from 32 to 59 percent. In another work done by Gang Zou and Zhigang Wang the number rose from 12 to 66 percent. In the case of the share of output sold on the market. The number shown is 49 to 60 percent

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<sup>49</sup> Chai, n.13, p. 76.

<sup>50</sup> William A. Byrd, *Chinese Industrial Firms under Reform* (Washington D.C., 1992), p. 12.

and 13 to 66 percent respectively (with a reference to the survey)<sup>51</sup> consistent reform package compared to the first stage of reform, the reform package during these years was consistent and greatly enhanced the role of market.

After the second round of reforms the autonomy of the State-owned enterprises was increased significantly. The year 1989 saw the event like Tiananmen Square incident; the reforms that were waged after the incident were cautious at a policy level and ground level. In spite of the widening circle of enterprises' autonomy, the growing losses of the state factories had posed a challenge. The challenges like these were the area of prime concern in forthcoming reforms.

#### **3.4.1.3. Third stage, 1991**

The decade of 1990s witnessed unprecedented changes within the SOEs. The new round of restructuring started taking shape immediately after the CCP's Central Committee meeting on 23 September 1991. The central topic of this Central work conference was to study the question of how to further improve state-owned large and medium sized enterprises. During his speech at the meeting Li Peng, directly held large and medium sized state-run enterprises, responsible for the breakdown and problems in the national economy. He put the problems in the following way; first, "the downturn in economic efficiency has not been reversed. Enterprises' profits have been declining, while stockpiles of finished products keep on growing. Debt defaults remain unsolved as no sooner

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<sup>51</sup> Cited in Jefferson, n. 48, p. 51.

has one debt default been settled than another one is incurred.”<sup>52</sup> Second, rising deficits and the third, “some major economic relations have yet to be straightened out. The more prominent ones are the irrational economic structure and the heavy tilts towards individuals in the distribution of national income. Both the share of state revenue in the national income and the proportion of state revenue at the Central authorities’ disposal are too low.”<sup>53</sup> On the eve of 1991 restructuring process, the loss of SOEs had reached a record high since the reform process began in China. In the year 1979, the total loss of SOEs was 3.638 billion Yuan, which reached 8.192 billion Yuan in 1988, after that the number increased double every year. For example, in 1990, 18.019 billion Yuan; and in 1991 it was 34.880 billion Yuan (See Table 3.2). This was the prime reason that caused a drastic change in the restructuring.

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<sup>52</sup> Text of the speech delivered by Premier Li Peng, “The Current Economic Situation and the Issues of further Improving State-owned Large and Medium-sized Enterprises”, at a CCP Committee work Meeting, 23<sup>rd</sup> September 1991, Reproduced by *China Report* (New Delhi), vol.27, no.4, April-June 2000, pp. 329-348.

<sup>53</sup> *ibid.*

**Table 3.1**  
**Increasing SOEs' losses**

Year	Loss (billion yuan)
1979	3.638
1980	3.430
1981	4.596
1982	4.757
1983	3.211
1984	2.661
1985	3.244
1986	5.449
1987	6.104
1988	8.192
1989	18.019
1990	34.880
1991	36.700

Source: Statistic Year Book of China's Industry Economy, 1994, p. 56.

The contradictions in the economic management system and economic operations made leadership very conscious. The fresh restructuring measures were based on the following problem:

1. The macroeconomic structure was irrational
2. Prices had not been rationalized
3. Neither the egalitarian practice sharing of food from the same big pot nor the practice of iron rice bowl has changed fundamentally.

4. The rate of increase in the income of workers and staff members was higher than the production growth rate, and distribution favours individual.
5. Enterprise management did not have sufficient awareness of the commodity economy and market mechanisms,
6. State-owned enterprises had a heavier tax burden and social burden than the other enterprises
7. An impact of weak market. <sup>54</sup>

Due to such a situation, Li Peng arrived at a conclusion that “fundamentally speaking, in order to enhance the vigour of enterprises and raise their economic efficiency, we should rely on efforts to deepen reforms, improve management, carry out technological transformation and make enterprises gradually become the socialist commodity producers and dealers who assume sole responsibility for their profits and losses and have the ability to transform, develop and restrain themselves.”<sup>55</sup> Based on this State Council prepared a list of eleven measures to be taken. Later Li Peng added one more to this and during the Third plenum of the Fourteenth Chinese Communist Party Congress, 1993, with a motive to create a modern enterprise system; they were approved-these measures are as follows:

1. Allocating more funds for technical transformation;

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<sup>54</sup> *ibid.*, p.338.

<sup>55</sup> *ibid.*

2. Reducing mandatory plan quotas for selected enterprises;
3. Increasing depreciation rates for selected enterprises;
4. Increasing funds for product development;
5. Providing additional working capital for certain enterprises;
6. Appropriately lowering interest rates;
7. Granting external trading rights to some enterprises;
8. Implementing a policy of double-guarantee for 234 key enterprises;
9. Clearing inter-enterprise debt;
10. Establishing 100 enterprises groups;
11. Reducing enterprises' burdens by eliminating adhoc levies and charges from local authorities, and
12. Reducing the income rate of enterprises from 55 percent to 33 percent.<sup>56</sup>

Along with these reforms the process of 'Corporatisation' also began. The most significant among other reforms introduced during this period. The renowned economist You Ji also called the effort as de-statisation.<sup>57</sup> The de-statisation was seen as a necessary step to revitalize the state industry through the nourishment of the private industries. The de-statisation here means withdrawal of state from all levels. The ongoing reform of Corporatisation in

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<sup>56</sup> An Excerpts of the points delivered by Li Peng in his speech, n. 52, pp. 339-341.

state factories is a further step in the transformation of the state ownership system. This was the reversal of the nationalisation movement in China in the 1950s, which eliminated private concerns. This was the necessary gateway for privatization; the concept spells out a Chinese strategy for ownership reform antithetical to the Soviet Shock Therapy prescribed to the former Soviet bloc, where the political authorities issued public decrees privatizing state factories.<sup>58</sup> The experiment of Corporatisation included both stock reform and share reform. The stock reform was supposed to create corporations of four major types: 1) Corporate Stock Companies of limited liability, 2) 'Internal shares', companies issuing non-transferable shares to staff, 3) Joint Stock Companies that can issue public offerings but cannot shares on the stock exchanges; and 4) Joint Stock Companies, which can trade shares on the stock exchanges. Along with this, State Commission for the Restructuring of the Economic System (SCRES) established four categories of shares: state shares, corporate, private shares and foreign shares. In 1993, SCRES prepared a comprehensive programme for the Corporatisation reform. This practically deals with the means of conversion and prescribes a time frame for it. The programme contained fourteen mechanisms for the conversion,

1. A new firm created by multiple investors may be made a Limited Liability Company (LLC) and each investor may hold stock certificates to express his or her limited liabilities,

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<sup>57</sup> You Ji, *China's Enterprise Reform: Changing State / Society Relations after Mao* (London, 1998), p.166.



2. Existing joint ventures may be converted to LLCs,
3. A Joint Stock Company (JSC) may be established through promotion,
4. A factory may be converted in to a Joint Limited Stock Company (JLSC) through specific offerings, with its existing stock capital turned in to share subscriptions,
5. A factory may be converted in to JLSC through specific offerings, with its existing stock turned in to share subscription,
6. A factory may be converted in to limited JSC through private placement, with its stock capital turned in to share subscriptions,
7. A number of factories may merge to form a LLC. With each party's assets evaluated determine the allocation of investment certificates,
8. A factory may establish a JSC in its subsidiaries through specific or public offerings,
9. A number of factories may merge to form a JSC with their fixed assets, patents, and marketing networks, etc. serving as shares,
10. A factory may be converted in to LLC with its creditors' rights as share subscriptions, while its fixed assets are transformed in to shares,
11. A factory may be converted in to LLC with the investment from various philanthropic foundations or insurance firms turned into stockholdings, while its fixed assets are transformed into shares,
12. A factory may be converted in to a LLC by absorbing foreign capital,

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<sup>58</sup> *ibid.*

13. A factory may be converted in to a LLC by absorbing capital from the domestic non-state sectors,

14. A factory may be converted in to JSC by issuing 'B-shares abroad'.<sup>59</sup>

As a result of these recommendations, numbers of measures were taken to implement the programme. Some of the important measures are as follows:

1. A large number of enterprise groups have been formed and granted full property management responsibilities. By the end of 1991 more than 2,500 enterprise groups of various sizes had been created.

2. A large number of large and medium sized state-owned enterprises have been transformed in to joint ventures, particularly through the injection of foreign capital. The CCP made its state policy to use foreign investment to save state firms. Subsequently, these were to be converted in to corporations. Shanghai, for instance, has converted one fifth of its 1,600 large and medium-sized factories in to joint ventures, including 143 projects with foreign investment averaging over than US \$ 5 million each and involving nearly 100 transnationals.<sup>60</sup>

3. Laws and Regulations regarding the Corporatisation reform have been promulgated to regularize the conversion process. The most significant is the Corporation law promulgated in 1993.

4. The improvement of the existing two- stock exchanges in Shenzhen and Shanghai has been given priority in order to accelerate the shares reform. This

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<sup>59</sup> The shares other than the 'Voting shares' (Equity shares entitling holders to vote in the election of directors of a company)

<sup>60</sup> *Guangming Ri bao*, 24 March 1993.

improvement is both technological, and institutional, with the establishment of legal and administrative surveillance.

5. In 1993, the State Council launched a national project to have all state-owned fixed assets re-evaluated.

6. Since 1 July 1993, the state sector has been implementing a new accounting system, which is designed according to international practices.

7. Intermediate organizations such as accounting and law firms and independent investment bodies are being developed.<sup>61</sup>

**Table 3.2**  
**Number of Industrial Enterprises**

Year	1995	1996	1997	1998	1999
Number of Industrial Enterprises (10 000 units)	734.15	798.65	792.29	797.46	792.99
Of the Total:					
State-owned Enterprises (including enterprises with controlling share hold by the state)	11.80	12.76	11.00	6.47	6.13
Collective-owned Enterprises	147.50	159.18	177.23	179.78	165.92
Individual-owned Enterprises	568.82	621.07	597.47	603.38	612.68
Enterprises of Other Types of Ownership	6.03	7.02	7.73	8.57	9.18
Share-holding Corporations	0.59	0.83	1.31	1.14	1.42
Enterprises Funded by Foreigners	5.40	4.43	4.38	6.25	6.23

Source: <http://www.allchinadata.com/english/industrial%20economy/table1.htm>

<sup>61</sup> Ji, n. 57, p. 182.

The Table 3.3 shows that in between 1995 and 1999 the numbers of SOEs have been reduced substantially, at the same time share holding, foreign funded, individual and the collective enterprises rose sharply. This signifies the intensity of the privatization measures.

This new round of reforms could not reduce the deficits of the SOEs and the burden of social security, which ended with the least success of these reforms. The number of loss-making enterprises went on increasing along with unemployment. The story of numbers tells some important things. According to Guo Shangquan,<sup>62</sup> in 1996 the total assets of the SOEs rose from 9642.5 billion Yuan in 1995 to 11029.05 billion Yuan, but the debt also grew from 5812.6 billion Yuan to 6704.18 billion Yuan in respective years, yielding a higher debt-equity ratio of 60.79 percent. The China Statistical Year Book in 1996 also stated that in 1995, among 87,905 industrial SOEs, the debt-equity ration for large SOEs was 62.3 percent for medium SOEs was 71.6 percent, for small SOEs was 71.5 percent.<sup>63</sup> The China Statistical Year Book (1995 and 1998) further gives detail about real financial profits and losses to SOEs between 1978 and 1998.

#### **3.4.1.4. New Phase, since 1998**

In the 'Year of Tiger' Chinese officials determined to intensify the enterprise reforms. The main thrust was on the cracking down the loss-making

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<sup>62</sup> Shangquan Guo, "China's SOEs and an adjustment of ownership", in *Toward 2020* (Beijing, n.d.), pp.52-53.

enterprises. The effort was legitimised by the concept, 'building modern enterprise system'.

Sheng Huaren, the Minister for State Economy and Trade Commission, speaking about the recent reforms says "The fourth session of the 15<sup>th</sup> Congress of the Communist Party of China made decisions on certain major issues regarding reform and development of state-owned enterprises. It emphasized that China will try its best to realize this target and carryout overall arrangements for reform and development of state-owned enterprises spanning the millennium. China adopted a series of drastic policies and measures in this regard."<sup>64</sup> The decisions taken in the fourth session of the 15<sup>th</sup> Congress of the CCP were the result of errors earlier neglected during the third stage reform years. The 15<sup>th</sup> Party Congress' targets for restructuring state-owned enterprises included: 1. Enabling the majority of loss making medium-to-large-sized SOEs, escape from the current difficulties within three years. 2. Enabling the majority of the large and medium sized state-owned backbone enterprises to initially adopt a modern enterprise system by restructuring, regrouping, carrying out renovations and reinforcing management. While marching towards more mature market and in a growing atmosphere of economic globalisation, it was really difficult to keep a soft approach towards the loss-making enterprises. The time came when the hindrance posed by the SOEs had to be eliminated permanently.

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<sup>63</sup> Je Wei, *The Great Tendency of the Chinese SOEs* (Beijing, 1999), p.2.

<sup>64</sup> Sheng Huaren, "Striving to Realize the Three Year Target of State-owned Enterprises Reform and separation of losses", in Laurence J Bhahm, *China's Century: The Awakening of the Next Economic Powerhouse* (Singapore, 2001), pp. 175-183.

The favourable domestic and international situation made the process inevitable.

The focus of the intensified restructuring is included with the following tasks:

1. Intensifying mergers and Bankruptcies, and perfecting the Mechanisms of the state-owned enterprises.<sup>65</sup> The environment of 'survival of fittest' was accepted in the case of state enterprises. The enterprises that have become hopeless of getting out of their loss-making plight have to be eliminated.

2. As Sheng Huaren argued "We shall severely further regulate and perfect the enterprises that have completed the reform to a corporate system. These enterprises shall establish a sound, legal personal management structure, and deepen the internal three-system reform covering labour, personnel and distribution within the enterprises."<sup>66</sup> The effort to construct a Modern Enterprise system was strongly expressed.

3. Speeding up implementation of transferring debt to equity shares.<sup>67</sup> The effort was very helpful for enterprises and as well as to Banks. The 'Equity Rights' was the safest way to refrain enterprises from debt making habit.

4. It was said that the further reorganizing of the enterprises has to be intensified. The large enterprises occupied by the central position, the policy *Zhua da fang Xiao* (Grasping the big and releasing the small) became the

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<sup>65</sup> Sheng, n.64, p.180.

<sup>66</sup> *ibid.*, pp. 182-83.

<sup>67</sup> *ibid.*, p. 181.

guiding line. The policy of 'walking out' was accepted. According to this policy profit making industries are allowed to move to developing countries.<sup>68</sup>

5. The congress also stressed the need to speed up enterprise technical transformation.

The need for improvement in management operations - costs, capital, quality and security production, expenditures, and competitive capacity, is strongly felt.

The reforms are still on and it is taking historical steps like selling SOEs, and laying-off the workers, which are not appropriate as far as the reason of the Chinese revolution is concerned. But on the other hand the steps proved successful in pushing China towards its newly defined development.

### **3.4.2. Methods of Restructuring**

In terms of methodology applied by the state officials and political leaders of China, it was mixed in nature. The Chinese government at different stages adopted a mix of methods to reform the SOEs. These mixed methods can be divided into three categories: decentralization of management, restructuring of management and property rights, and privatization.

#### **1. Decentralization of management**

Decentralization of management included an increase of managerial autonomy and then the establishment of the contract management responsibility system. They also included simplifying administration, reducing taxes and

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<sup>68</sup> *ibid.*, p. 182.

mandatory planning, and practicing the profit incentive system. The main theme of the enterprise reform policies between 1979 and 1993 was decentralization from government to enterprises under 'expanding enterprise autonomy' and 'increasing retained profits' to improve incentives. The state-owned enterprises received more authority over autonomy in production decisions, Wage discretion. The SOEs were allowed increased control over wages and benefits, expansion in market activity, changes in investment patterns, and increased competition. This helped in improving the productivity of firms. Thus so-called managerial benefits were as follows:



**Table 3.3**  
**Increased Autonomy of SOEs**

Year	Retention Rate		Autonomy in Production Decisions	Wage Discretion #	Management Responsibility System#	New Management Appointed after 1980#
	Bases <sup>\$</sup>	Marginal @				
1980	7	11	7	1	0	9
1981	19	12	8	1	0	9
1982	22	11	10	1	0	15
1983	30	14	14	2	1	25
1984	34	17	25	9	4	40
1985	37	17	35	9	4	40
1986	39	19	40	12	8	61
1987	38	23	53	20	42	75
1988	39	26	64	32	83	85
1989	39	27	67	35	88	94

Notes: Based on a 1991 retrospective sample survey of SOEs by the Chinese Academy of Social Sciences (CASS).

@ Portion of profits that could be retained if profit exceeded the base level.

\$ Portion of profits that could be retained if profits did not exceed a specified base level.

# Share of firms in the sample.

Source: Yi-Chong Xu (1996), fn.4, as quoted in World Bank, *China 2020: Development Challenges In the New Century* (Washington D.C., 1997).

Reproduced in Singh, Surjit, "Economic Reforms and State Enterprises in China" in *China Report* (New Delhi), vol. 34. no.2, 1998, pp. 199-212.

This strategy was prompted to a large extent by the over-centralization of the authority in the past; the successful experience of the contracting system in agriculture; the slowness in progress of fiscal, financial, and price reforms; and the political constraint on privatization. In the period between 1985 and 1992,

the restructuring category of decentralization of management methods was introduced for all SOEs.

## 2. Restructuring of management and property rights

The releasing of the property rights was the major step taken by the Chinese government to restructure the SOEs. The management sector also experienced the restructuring. Chinese government adopted the following measures: setting up national enterprise groups, by purchasing assets and stocks of subsidiaries; merging of SOEs; operating cooperatives; leasing arrangements; spin-offs; and turning debt into shareholders' equity.

3. The third category of reform method was privatization. The privatization efforts were mostly common in the case of small SOEs. The State Economic and Trade Commission (SETC) report categorically recommended the invariable privatization of all the small SOEs.<sup>69</sup> SETC defended its argument saying that small state firms should be privatised in order to generate money to finance the development of the priority sectors a state social welfare system and relocation of state staff.<sup>70</sup> This method popularly known as *Zhua da Fang Xiao*, grasp the large and let go the small, represents the plan of the state.

This came in different forms, such as outright sale or auction, bankruptcy, creation of public companies with listed stocks, mergers and acquisitions, formation of share holding enterprises (companies limited by shares or companies with limited liability), shares of cooperation's, and joint ventures.

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<sup>69</sup> SETC, "Creating a Modern Enterprise Mechanisms that suits the Market", Cited in Ji, n. 67, p. 169.

Reason for setting up joint ventures was to attract foreign capital. It was also hoped that setting up experimental joint-stock companies would raise funds to circumvent credit quota regulations imposed on banks. In all cases of limited liability companies and in the majority of cases of joint-stock companies, new funds were raised by private placement, often through closed subscription by employees and institutional investors.

To know the results of privatization efforts, we can see the developments that took place in Zhuchen county of Shandong province, which was Chinese Government's showcase for privatization. Here a reform took place in 274 small SOEs. The local government carried out a complete reform of them between 1992 and 1995, applying aggressive privatization methods. Nine of these small SOEs became limited liability companies; 204 converted into the company limited by shares; 18 were auctioned off; 35 were leased out; five were transformed by mergers and acquisitions; the remaining three appeared in court for bankruptcy.<sup>71</sup> The effects of the privatization can be seen in the Table 3.3 and Table 3.5 which clearly shows that the number of the state industries is decreasing and with the growth of private enterprises the share of SOEs is also decreasing dramatically, this is the result of conscious efforts made by the state. In the year 1978 the output share of the SOEs (compare to the total industrial output) was 77.6 percent, whereas, the collective sector had a share of 18.5 percent. The periodical structural changes in the state industries, and increasing

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<sup>70</sup> *ibid.*

competition from the emerging non-state enterprises, on the base of quality and service, started occupying the market. After ten years, during the concluding years of the second stage reforms, the industrial output share of each sector was 56.8 percent and 24.4 percent respectively. The private industries, in the form of individual-owned, had also occupied their share, which was 4.6 percent. With the beginning of the new phase of reforms in 1998 the share of the three industries was 28.2 percent, 35.3 percent, and 18.1 percent respectively. The structural reforms in the state enterprises affected its performance in the market adversely. This led to the increase in number of impoverished enterprises, which later created various social problems.

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<sup>71</sup> Economic Research Center of Academic School of Chinese Communist Party, *Research of Reforming the Small SOEs* (Beijing: Economic Science Press, 1996)

**Table 3.4**  
**Performance of State-owned Enterprises during the reform period (share**  
**of the total value of Industrial Output, 1978-1999)**

Year	State-owned Enterprises	Collectively-owned Enterprises	Individual-owned Enterprises/Private
1978	77.6	18.5	..
1980	75.1	19.8	0.0
1981	74.3	20.0	0.0
1982	73.3	20.3	0.1
1983	73.8	20.7	0.1
1984	67.6	23.6	0.2
1985	64.9	23.7	1.8
1986	62.3	23.9	2.9
1987	59.7	23.9	3.9
1988	56.8	24.4	4.6
1989	56.1	n.a.	n.a.
1990	54.6	35.7	5.4
1991	52.2	n.a.	n.a.
1992	48.4	38.0	6.8
1993	46.9	34.0	7.9
1994	37.3	37.7	10.0
1995	33.9	36.5	12.8
1996	28.7	39.5	15.4
1997	31.6	38.1	17.9
1998	28.2	38.4	17.1
1999	28.2	35.3	18.1

Note:

.. Negligible

Collective Enterprises = Includes Urban as well as Township Enterprise

Private Enterprises = are those which are owned by individuals

Sources:

PRC National Bureau of Statistics, *China Statistical Yearbook*, China Data Centre, and Foreign Broadcast International Service (various issues).

This struggle for restructuring is in a way struggle for a 'decisive victory' for economic development. The reform process that started since 1978 seems to be unending process of development and emerging crisis. In the quest of achieving development path, China is not only facing the monitorial problems but also the problems at the societal level. The prime concern of the Chinese government is towards the societal concerns of the reforms. The emergence of the economic interests in the Mainland China is a great achievement of the Deng's Second Revolution, but along with that various other societal problems have cropped up in China.

## **Chapter 4**

# **Impact of the Process of the Economic Reforms and Restructuring of State-owned Enterprises on Urban China**

## Chapter 4

### Impact of the Process of the Economic Reforms and Restructuring of State-owned Enterprises on Urban China

#### 4.1. Introduction:

With the beginning of the 21<sup>st</sup> century the tasks and the challenges of the Chinese government have increased. One of them is to resolve the problems occurred during the economic reforms and the restructuring of the SOEs. The various crises in urban China have resulted from the reforms. Despite the impressive economic growth, the economic reforms have also resulted in certain negative effects on China's economy and society.

For the Chinese leaders, carrying the reforms forward and maintaining social stability have to be achieved in tandem. However, some of the consequences of the reforms are, the rising income disparity and inflation in urban China. As far as the implications of the restructuring of the SOEs are concerned, it has also created a number of negative results such as the erosion of the *Danwei* system, increasing inequality in urban China, subordination and devaluation of health care, and the most inflammatory crisis of unemployment. The outcome of these processes is growing number of protests in urban China. In this chapter the thrust has been given to these problems, which are risen by the reform measures.



## **4.2. Impact of Economic Reforms on Urban China**

### **4.2.1. Tension between Economic Growth and Socialist Objectives**

Since the end of the 1970s, China has achieved an impressive economic growth. However, transition towards market economy, is not without problems. Widespread and deepening economic reforms in urban areas, especially the reconstruction of state-owned enterprises, led to unexpected societal and economic problems. The present situation of development has brought the country to a position where the ideology and reality are in conflict with each other. The new interpretation of ideology by reformists, in the name of 'market socialism' and 'seeking truth from facts', has proved useful in rationalizing the reform process. The objectives of socialism and the prerequisites of economic growth are in contradiction.

The experience of China's post-Mao economic reforms has also shown the importance of economic development in the social context. Strategies of decentralization and the uneven regional development are the two main features of China's economic growth. The opening of the economy shackled the basic objectives of socialist economic growth. The new reform aimed to end the restrictions like social security. The economic growth has been achieved at the cost of social development. Before the introduction of reforms in 1978, an effort was made to establish social equality at the cost of economic development. The process was reversed in post-Mao era, where utmost priority was given to

development and restructuring the country's economy. To be very specific, the feeding of SOEs was considered as an ideological and moral responsibility of the state, which was done even when it was against the developmental values of the economy. The adoptions of the new way of reform policies have resulted in, the confrontation between China's central and local governments, the increase of inequalities among China's urban regions, and the rise of income gap between China's rural and urban societies. In addition, the success of economic growth has led to environmental pollution, labour disputes, bureaucratic corruptions, social crime and unrest. The problems and issues are especially challenging to Chinese policy makers because this has deteriorated country's social stability. Under the traditional model, the systematic stratification of decision-making, implementing and reformulating of policies were rested with center. The nature of the decision-making was rigid. Under tight control of the single party authority, there were relatively few cases of crime and social unrest and no official reports of about these cases and problems.

With the new reform programme under Deng, the tightening of government expenditure took place and as a result, the restructuring process of the SOEs began. The problem became severe when the economic reform process started scissoring social stability schemes. This became the reason for creating social instability and replacing the objectives of socialism with the commitment to achieve dynamic growth rate. Soon the scene became growth versus development. Economic growth stood against the social development.

Sometimes, development and growth are said to be the same, but both vary from each other. The development is a process in which the improvement of all people's lives is expected, whereas, the growth involves measures like, how the production of all goods and services in an economy is increased by what means—first is the utilization of resources such as labour or capital that are underused; the second involves, increasing the output (of a given quality) per unit of resources used in the production process.<sup>1</sup> In the Mainland China the economic 'growth rate' is growing and it is mixed with problems like the uneven distribution of income and assets.

For the Communist Party of China, it is a challenging task to strike a balance between the economic growth and development while maintaining continuation to the socialist ideology. With the introduction of free entrepreneurial activities in the Chinese economy, 'profit' became the center of market activities. The reinvested profits fueled economic growth. State used to collect the profits from individual enterprises to support social security programmes. This was done in the name of 'social responsibility'. Gradually, at one point the feeding of society, at the cost of profits gained by enterprises felt to be unhealthy. The objectives of Chinese socialism like providing 'social security', 'full employment', and 'controlling inflation' are no more harmonious with the economic development. Recently, the government decided to come

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<sup>1</sup> Terry Cannon, "Introduction", in Terry Cannon, *China's Economic Growth: The Impact on Regions, Migration and the Environment* (London, 2000), pp. 11-12.

down harshly on bankrupt state enterprises, which was necessary for the acceleration of reform programme. This also led to the laying-off of tens and thousands of enterprise workers. This was contradictory as far as the socialist objective of the government was concerned. The policies like 'relief fund' for laid-off workers and for those who are waiting for job commenced to pacify the growing unrest, which was again done at the cost of economic development. This has created a dilemma in the minds of Chinese leaders, to whom; the economic growth has to be achieved by avoiding extreme impacts of the reform process, which is not less than impossible.

Problems like increasing unemployment, regional income disparity, and abandonment of social security, paralysing *Danwei* system are the examples of growing list of problem areas of economic reforms. This shows, that the social objectives of the Chinese state cannot survive along with the increasing pace of economic reforms. And presently, the earlier one is a very favorite for the Chinese leaders.

#### **4.2.2. Rising Income disparities**

Though, the Chinese government is committed to egalitarianisms, the result of the reforms has created a wide income disparity. There are large disparities in wage incomes between the urban and rural residents, between different regions and even among the urban residents.

The signs of serious income disparity began to grow up soon after the Chinese government made available the favourable conditions for regions and individuals to get rich earlier through special and preferential policies. Though, the effort to make 'some' rich and to make others to follow better, fascinated many but it eventually led to income disparities. First, the unlaw factors,<sup>2</sup> which includes,

□ Corruption in the government institutions and organizations has caused significant decrease in the state finances, in the recent years.

• There has been illegal large-scale diversion of the state assets to private hands, which is later used for personal investment, leading to losses. One estimate puts the losses 100 million a day or 36.5 billion a year.

• A portion of the corporate income is being disguised as personal savings to avoid official supervision. Chinese banks pay a higher interest on personal bank deposits and bonds, which is thought to have also contributed to such phenomena.<sup>3</sup>

• According to the government statistics in 1996, roughly about 50 percent of all individual income tax is drained off yearly. Plus, over 90 percent of self-

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<sup>2</sup> The term is used by Taejoon Han, in his article "China: A Shared Poverty to Uneven Wealth?" Cited at <http://www.gwu.edu>

Here the unlawful factors means, exploitation of policy, systematic and administrative loopholes, and abusing individual's power to gain personal wealth through illegal profiting, and tax evasion.

<sup>3</sup> Business Times (Singapore), "A Chinese High Savings Puzzle", May 30, 1996.

employed business people and 80 percent of private enterprise owners have a record of tax dodging.<sup>4</sup>

And the second reason is the uneven distribution of resources between different regions. The coastal versus interior areas is no more a hidden secret.

□ Irony is that the number of industrial labour force worked and lived in the eastern China was almost 49 percent of the total number in 1996,<sup>5</sup> and the other parts of the country, which are rich in resources, still remained deserted. Only one fourteenth of the nations coal reserves are locked in coastal regions while more than 92 percent of its coal deposits are in the interior. About 90 percent of the nation's forests are in the central and western areas while less than 10 percent are in its coastal regions.<sup>6</sup>

□ The coastal areas possess a well-developed financial base and manage a relatively high level of capital accumulation. The flow of the foreign direct investment is making the coastal regions richer. In the long-term capital flow may permanently seal the progress path of the interior. (See Table 4.4(a) and 4.4(b))

□ The per capita income of the coastal provinces is higher than the interior regions.

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<sup>4</sup> Jingxian Lu, "China: State works to narrow Income Disparities", Reuter Textline, *China Daily*, December 10, 1996. online at [www.chinadaily.com](http://www.chinadaily.com)

<sup>5</sup> Han, n. 2

<sup>6</sup> *ibid.*

Productivity and living standards in the coastal parts are higher than that of the interior regions. (See Table 4.1)

- Disparities in the technological capabilities between the coast and the interior are significant.

**Table 4.1**  
**Per Capita Annual Income By Region (1994)**

<b>Eastern</b>	<b>Per Capita Annual income</b>	<b>Central</b>	<b>Per Capita Annual Income</b>	<b>Western</b>	<b>Per Capita Annual Income</b>
Liaoning	2099.4	Heilongjian	1541.01	Shanxi	853.27
Hebei	1442.48	Jilin	1456.39	Gansu	1041.97
Tianjin	3383.85	In Mongol	1112.49	Ningxia	1020.06
Beijing	4417.85	Shanaxi	1186.92	Sichuan	985.39
Shandong	1682.51	Henan	1019.15	Yunnan	942.46
Jiangsu	2613.54	Anhui	1047.83	Guizhou	609.8
Shanghai	7555.89	Hubei	1341.4	Qinghai	1055.46
Zhejiang	2443.99	Hunan	977.06	Xinjiang	1456.63
Fujian	1674.75	Jiangxi	1106.78	Tibet	930.86
Guangdong	2450.21				
Guangxi	842.88				
Hainan	1753.22				

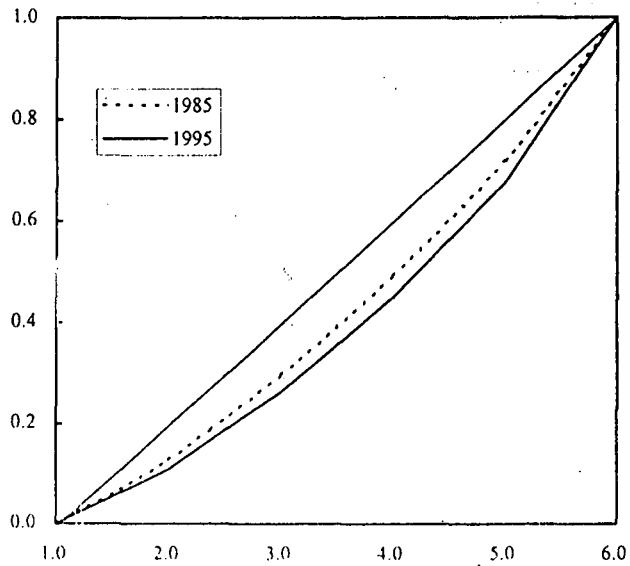
Source: China Statistical Yearbook, 1995

Income distribution has become increasingly unequal since reforms started in 1978. The Lorenz curve depicts that the inequality line is bending down more and which shows the increased income inequality<sup>7</sup> (see Figure 4.1).

<sup>7</sup> The Lorenz curve is a graphic depiction of equality of income distribution. A graph is plotted against a horizontal axis measuring the proportion of the total population of income earners (cumulative percentage of persons) and a vertical axis measuring the

Figure 4.1

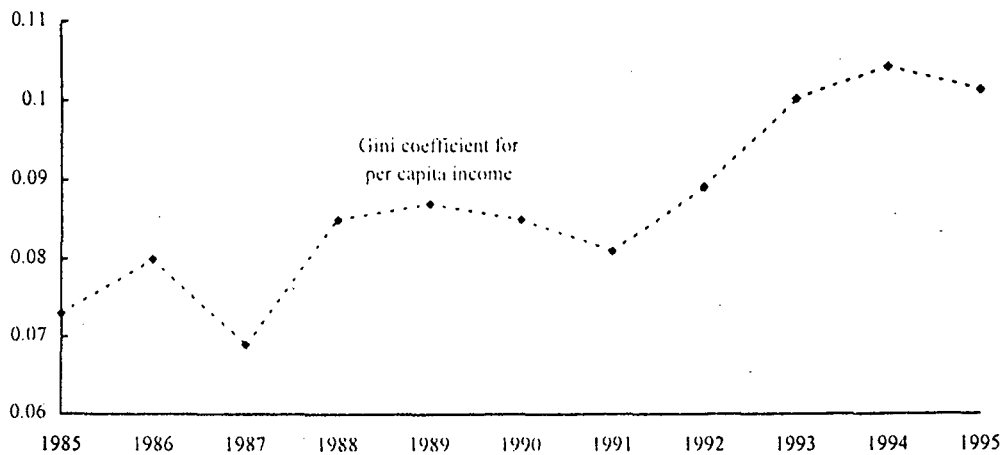
Lorenz Curve for Per Capita Income of Urban Residents, 1985 and 1995



Source: Yabuki, p. 5.

Figure 4.2

Gini coefficient for Per Capita Income of Urban Residents



Source: Yabuki, p. 86.

proportion of the total income earned by persons (cumulative percentage of income). If income is distributed complete equally, the plotted line is a diagonal line. The curve-plotted below the diagonal line indicates inequality, and the area between the curve and the diagonal line indicates the degree of inequality.



The Gini coefficient<sup>8</sup> reveals that income inequality in urban China has intensified (see Figure 4.2). It is admitted that imbalanced development among regions and among different groups of population was still prominent, and the real income of some households in certain provinces and regions declined to some extent. The life of some of the low-income households is still difficult.<sup>9</sup> The regional inequality is the responsible for this. Here, regional inequality does not mean between urban and rural but intra-urban that is within the urban China. The adoption of open door policy, and making of coastal region as a laboratory region for the capitalist experiment, itself showed that China has adopted an uneven, imbalanced regional development strategy. The uneven strategy allowed differential development among the regions and granted preferential policies to the coastal region so that it might develop faster and become the engine of growth for the country. The new policy and strategy are totally different from

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<sup>8</sup> The Gini coefficient is a measure of the correlation between the Lorenz curve (the inequality line) and the diagonal line (equality line). If the Lorenz curve line tracks the diagonal line exactly, indicating complete equality, then the value of the coefficient would be zero. If all income is in the hands of the ruler individually, then the value is one. Thus, the values of the Gini coefficient are from zero to one: the closer to one, the greater the inequality.

According to the *Penguin Dictionary of Economics*,

A coefficient, based on the Lorenz curve, shows the degree of inequality in a frequency distribution. It is measured as:

$$G = \frac{\text{Area between Lorenz curve and } 45^\circ \text{ Line}}{\text{Area above the } 45^\circ \text{ Line}}$$

If the frequency distribution is equal, the Lorenz curve coincides with 45° Line, and  $G = 0$  (Bannock, Graham, et.al. (Eds.), *Penguin Dictionary of Economics* (London, 1998), p.176.)

<sup>9</sup> *China Statistical Yearbook*, 1997, p. 202.

the traditional and balanced development policy and the interior – oriented strategy.<sup>10</sup>

Before the economic reforms started in the late 1970s, Chinese people enjoyed ‘tenure terms’, because their employment was a life-long appointment. In addition, the remuneration system was based on egalitarian principles. All people had to share an equal but relatively low wage. The motto like ‘eating out of a big pot’ created a sense of ‘equal distribution’ among the different sections of workers. Despite the fact that people had very low labour mobility, they did enjoy low unemployment, comprehensive occupational welfare and high degree of job security. Although, people in the pre-reforms era had very low salaries, the social wage administered and delivered at enterprise level was important in giving employees access to an expected life style. More importantly, income inequality was maintained at a very low level (the Gini coefficient was around 0.16) (see Figure 4.2) before the reforms took place in the late 1970s.<sup>11</sup>

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<sup>10</sup> Kuotsai Tom Liou, *Managing Reforms in Post-Mao China* (Westport, 1998), p.65.

<sup>11</sup> Peilin Li, *Report on the Social Stratification in China* (Shenyang, 1995), pp. 335-36, Cited in Ka-Ho Mok, *Social and Political Development in Post-Reform China* (London, 2000), pp.24-25.

**Table 4.2**  
**Inequality measures in urban China**

Inequality measures	1999		1995	
	Monetary income	Disposable income	Monetary income	Disposable income
1	0.0308	0.0312	0.0404	0.0382
2	0.0781	0.0777	0.0973	0.0918
3	0.1369	0.1345	0.1640	0.1549
4	0.2066	0.2020	0.2404	0.2271
5	0.2889	0.2810	0.3255	0.3079
6	0.3833	0.3717	0.4201	0.3976
7	0.4906	0.4779	0.5261	0.4993
8	0.6160	0.6054	0.6469	0.6185
9	0.7694	0.7613	0.7903	0.7690
10	1.0000	1.0000	1.0000	1.0000
Gini coefficient	0.306	0.318	0.255	0.285
Mean of income (Yuan)	6114	8213	4757	6293

Source: Peilin, n.11, pp. 24-25

In 1990s, the situation is becoming much more serious, the income gap between the highest income group and the lowest income group is widening rapidly. It is worthy to be noted that the income inequality rose faster than income growth.

The results shows, that Gini coefficient of monetary income rose from 0.255 in 1995 to 0.306 in 1999, by 20 percent, although, the average monetary income in constant prices grew by 25.5 percent in the same period. The pattern

appears in individual disposable income, showing 11.6 percent increase in income inequality and 30.5 percent in average income.<sup>12</sup> (Survey)(see Table 4.2)

As the survey shows, Gini coefficient of the difference in monetary income also varied at provincial and city level (see Table 4.3) for example, the Gini coefficient of the each Beijing and Liaoning province was 0.2192 and 0.2034 in 1995, which rose up to 0.2481 and 0.2706 respectively in the year 1999. And in the case of Western provinces like Sichuan and Gansu the Gini coefficient in 1995 (of each province) was 0.2105 and 0.2292 which rose to 0.3002 and 0.2642 respectively. So there was intensive variation in income inequalities. The western provinces are behind the eastern provinces, but on the western front itself the situation of inequality is varying. As shown in Table 4.3 in the cities like Chengdu and Zigong of the Sichuan province, the Gini coefficients were 0.1992 and 0.2287 in the year 1995 and in the year 1999 those were 0.2576 and 0.2652 respectively. In the Beijing itself it rose from 0.2192 (1995) to 0.2456 (1999).

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<sup>12</sup> The information has been taken from the Survey conducted by the Institute of Economics, Chinese academy of Social Sciences, with the assistance from the State Statistical Bureau in Beijing. The data found in this survey is used at certain places in this chapter. The data cited in,  
Li Shi, "Economic Insecurity of Urban Household in China in 1990s", The paper was presented at the Workshop on Development Toward Human Economic, Social, Environmental Security, October 30 - November 1, 2000, Beijing.

**Table 4.3**  
**Gini coefficients in Disposable income Urban China by city, 1995 and 1999**

Province / City	1999		1995	
	Monetary income	Disposable income	Monetary income	Disposable income
Beijing	0.2456	0.2481	0.2192	0.2466
<b>Liaoning Province</b>				
Shenyang	0.2710	0.2513	0.1992	0.1973
Jinzhou	0.2852	0.2481	0.2162	0.2031
<b>Jiangsu Province</b>				
Nanjng	0.2609	0.2278	0.2257	0.2279
Xuzhou	0.2335	0.2394	0.2006	0.1978
<b>Henan Province</b>				
Zhengzhhou	0.2323	0.2476	0.2333	0.2219
Kaifeng	0.2884	0.2150	0.2429	0.2300
Pingdingshang	0.2339	0.3504	0.1884	0.2064
<b>Sichuan Province</b>				
Chengdu	0.2576	0.2244	0.1992	0.2041
Zigong	0.2652	0.2399	0.2287	0.2092
<b>Gansu Province</b>				
Lanzhou	0.2386	0.2581	0.2082	0.1982
Pingliang	0.2286	0.2265	0.2455	0.2430

Source: Survey jointly conducted by Institute of Economics, Chinese Academy of Social Sciences, with the assistance from the State Statistical Bureau in China (Beijing: State Statistical Bureau, 1999), various pages.

As far as the foreign direct investment (FDI) in China is concerned, it has also played a very crucial role in creating income gaps between the coast and the interiors.

**Table 4.4 (a)**  
**Geographic Polarisation of FDI (% of total flows)**

Provinces	Year 1998
Coastal	85.5
Central	14.0
Western	0.5

Source: www.oecd.org/

**Table 4.4 (b)**  
**Trends In FDI flows in the Coastal Provinces (% of total flows)**

Province	1979-1991	1997-1998
Beijing	8.5	4.1
Tianjin	1.7	5.1
Hebei	0.6	2.8
Liaoning	4.2	4.9
Shanghai	5.8	8.7
Jiangsu	2.7	13.4
Zhejiang	1.2	3.1
Fujian	6.5	9.3
Shandong	2.4	5.2
Guangdong	36.6	26.3
Coastal Provinces	69.9	82.9

Source: *ibid.*

The FDI situation in China is immensely polarized. The ten coastal provinces,<sup>13</sup> that account for 36 percent population actually absorb over 85 percent of FDI (see Table 4.4(a)). Three Maritime Provinces alone account for nearly 50 percent of these investments flows (Guangdong 26.3 percent, Jiangsu

<sup>13</sup> This includes, Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, and Guangdong.

13.4 percent, and Fujian 9.3 percent, see Table 4.2, Trends in the coastal province). As the Table shows, that the coast attracting 85.5 percent of total FDI flow in 1998, the Central provinces hardly received 19.0 percent of total FDI flow, and the FDI flow in Western provinces was very meager at about 0.5 percent. The heavy concentration of FDI in the coastal provinces caused an aggravation of economic and social disparities. Due to lack of sufficient industrial linkages between the provinces, the low level of inter regional cooperation and the relatively underdevelopment level of domestic economic integration have impeded the dissemination of the benefits of FDI in coastal areas to other parts of the country.

In urban China, low-income groups are suffering because of low-income means. This section is more likely to fall below poverty line before. The estimated poverty indices for each city in 1995 and 1999, indicates, that in average, the poverty rate measured by head-count index was going up from 1995 to 1999, by nearly 10 percent. The poverty gap is increased by 36 percent. Of course, there are exceptions like Kaifeng, Lanzhou, and Pingliang.<sup>14</sup>

#### **4.2.3. Inflation**

The total control of inflation was one of the main objectives of People's Republic of China.<sup>15</sup> China has continuously experienced sharp price rises

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<sup>14</sup> Survey, no.12

<sup>15</sup> The main reason behind this was during the war period and the civil war on its peak the domestic prices had reached the sky. The unprecedented growth in inflation caused people furious and as a result made nationalist government loose its popular support. China leaders after 1949 were, therefore, obsessed with controlling inflation out of fear that it could

during the reforms years. The official retail price indices ranged from the smallest of 0.7 in 1978 to the largest 21.7 percent in 1994 and showed an average annual increase of 7.5 percent between 1978 and 1995 (see Table 4.5 (b)). With the growing marketization, prices rose higher than ever before in the history of independent China. The inflation rate was very high and was unacceptable to the Chinese people. Common Chinese were used to the subsidized low commodity rates, and costs of services. With the reforms, artificially kept low prices were freed. Now, for China, freezing the commodity prices was difficult. A level of almost complete price stability became no more predictable in China.

“Low inflation rates were possible until the 1980s because the prices of goods in short supply were kept artificially low by centrally administered stable pricing policies.”<sup>16</sup> These kind of anti-inflationary policies are always possible in the centrally planned economy. And that’s why it was easy in China to introduce such policies. The state bureaucrats took care of the value of land, labour and resources. Through the budgeting, state used to allocate whatever money and materials necessary for keeping key enterprises running. These enterprises simply used to pass the additional costs of extra inputs and inefficient production to the state or to other enterprises in the form of increased

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reignite economic and political instability. The post-1949 Chinese leadership determined that low inflation or even no inflation was an important social objective. In other countries the policies to control inflation comes along with the other major economic policies, but in case of China this has come with the historical experience.

<sup>16</sup> Suzanne Ogden, *China’s Unresolved Issues: Politics, Development, and Culture* (New Jersey, 1995), p. 293.



prices. And later, this used to become input prices for the producer goods subsidized by the state. This means that to control inflation, state must provide an even larger budget to enterprises and subsidized prices to consumers. "By the early 1980s, subsidies had risen to one-third of the state budget."<sup>17</sup> But the situation at the ground level was very different like, bank savings increased, long lines for product and short supply, long waiting periods for products ordered, and ultimately black markets, smuggling, and extreme pressures on the 'back door' to supply the goods needed. The cheap goods were always sold at high prices to special customers and the remaining part of the products was distributed to the low-income group. Later, the price reforms took place, which tried to support market, and this was proved successful in tackling corruption, black markets and hoarding. But the control of prices became slippery. The urban population, most of them who were still tied in to the state-controlled pattern of wages, had insisted that their wages be raised to compensate for the increased cost of agricultural products. Though, the prices were not fully released, it was enough to result in a spurt of growth in the economy. But this was not to happen. Especially sharp and continued inflation caused strong resentment from citizens of urban China, resulting in political and social instability. The people's dissatisfaction with growing inflation was considered as one of the major reasons for the Tiananmen Square demonstration in Beijing in

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<sup>17</sup> *ibid.*

1989. As shown in Table 4.5 (a), retail prices rose up to 18.5 percent in 1988 and 17.8 percent in 1989, two of the highest rates in the 18 years of the reforms.

In the 1990s situation became more critical. After the third phase of restructuring of SOEs, inflation went out of state's control. But Chinese leaders showed conscious and hurried efforts to bring down inflation in the early 1990s, for example, after the high inflation rates in 1988 and 1989, the Chinese government was able to reduce the retail price indices from 10.2 percents to 7.6 percent in the early 1990s. The government achieved this through both administrative and economic means, (e.g. controlling credit amounts of regional banks and raising interest rates) during the period of the slowdown of economic reforms. Inflation, however, rose again after 1993 along with the rapid economic growth after the reassurance of economic reforms in 1992. As a reason of this Chinese state sources were arguing, "The primary cause of inflation was not scarcity in the face of end consumer demand but over-expenditure on fixed assets and the overissuance of banknotes."<sup>18</sup>

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<sup>18</sup> Kate Hannan, *Industrial Change in China: Economic Restructuring and Conflicting Interests* (London, 1998), p. 101.

**Table 4.5 (a)**  
**Retail Price Index 1978-1995**

Year	Retail Price <sup>+</sup>
1978	100.7
1979	102.0
1980	106.0
1981	102.4
1982	101.9
1983	101.5
1984	102.8
1985	108.8
1986	106.0
1987	107.3
1988	118.5
1989	117.8
1990	102.1
1991	101.9
1992	105.4
1993	113.2
1994	121.7
1995	114.8

**Table 4.5 (b)**  
**Average annual increases (%) \***

Year	Retail Price
1978-1995	7.5
1978-1984	2.5
1985-1988	10.5
1989-1991	7.6
1992-1995	13.8

Note: + Retail price index is based on preceding year=100.

\* Numbers in parentheses are calculated average annual increases in the specific period.

Source: State Statistical Bureau, *China Statistical Yearbook* (1996: p.114, p.255); China Statistical Abstract (1990:p.20) in Kuotsai Tom Liou, *Managing Economic Reform in post- Mao China* (Westport, 1998), p.54.

The prices that the government has set were well below the level of the shadow prices,<sup>19</sup> particularly where the goods are raw materials or a product or service that has previously subsidized the real cost of worker's wages e.g. health care, education and housing. So in short, the release of these prices in the market made them to rise high. Another cause for the steep inflation was also related to the deregulation of prices, and that was the changing consumer behaviour influenced by changed prices. The Chinese consumers' reaction to the government decision created the situation more critical. As soon as, the prices were freed from the government's control, consumers believed that prices that have been released from government control would increase, and they bought excess, in anticipation and the supply of relevant goods was stressed. That's why inflation was rising sharply, government price controls on a range of items had recently been lifted, but the panic buying led to a substantial increase in already rapidly rising prices. When in 1992, as part of 'the core reforms' Banks and SOEs were made responsible for their own performance, the situation of inflation became further critical. The profit making through large selling and at increased prices became important part of the enterprise activities. The increase of inflation during the reform years was related to both economic growth and reforms policies. In general, inflationary pressure is usually associated with

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<sup>19</sup> *Penguin Dictionary of Economics* defines Shadow Price as, "a concept applied to situations where actual prices cannot be charged, or where actual prices charged do not reflect the real sacrifice made when some activity is pursued."\* And this is possible only in an economy, which is not competitive and not following the path of perfect competition.

\* Graham Bannock, et.al. (eds.), *Penguin Dictionary of Economics* (London, 1998), pp. 378-79.

rapid economic growth because inflation is considered as one of the side effects of economic growth. It is clear that along with the rapid economic growth, the leaders need to continue to pay attention to the issue of inflation in future. It has become a cause for the income disparity and social anger.

#### **4.3. Impact of Restructuring of State-owned Enterprises on Urban China**

The impact of restructuring of the SOEs was wide. The urban resident, who was very much socially and economically related to the state enterprises, became hopeless. The social benefit schemes run by the state came under threat. The erosion of *Danwei* system was the first obvious impact of the restructuring process, which followed by unemployment and social instability in urban China. The challenges in front of Chinese leaders are increased.

##### **4.3.1. Erosion of *Danwei* system**

The social welfare and the social control had always been a major priority area for the People's Republic of China. Articles 42, 43, 44 and 45 of the Constitution<sup>20</sup> define, the provision of social welfare in China. These articles reflect both the coverage and magnitude of social security for the target populations. The constitutional provisions of benefits include increases in remuneration, a system of retirement and pension, material assistance, social

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<sup>20</sup> In detail, Article 42 of the Constitution states that citizens have the right, as well as the duty to work...All working people in state enterprises and in Urban and Rural collectives should perform their tasks with an attitude constant with their status as 'master of the country'; Article 43 states that working people have the right also to rest; Article 44 explains that the prescribes the system of retirement for workers and staff in enterprises and undertakings and for functionaries of the state; Article 45 says that citizens have the right to get material assistance from the state and society when they are old, ill or disabled.

insurance, medical and health services, preferential treatment and vocational training. This function of the Chinese state is similar to that of welfare state. And the system of safety net was introduced under the *Danwei* system. Thus, it is no surprise that the Chinese, in the grip of underdevelopment and with a far lower per capita income available, have found that the costs of such welfare functions have taken their toll on economic growth. To fill up the exchequer and keep the monetary balance, heavy taxes were levied on enterprises, which were already trapped in between their social obligation and obeying the government directions or rather orders. As far as non-wage benefits are concerned i.e. pension, housing and health care, government is cutting down its expenditure.

Chinese government had a firm control over society through economic mechanism like *Danwei*. The problems of social control occurred during the process of economic reforms, because many of these mechanisms have been removed with the purpose of increasing incentives and productivity. With the shrinking responsibilities of *Danwei*, the independent market forces seem to be causing social instability in urban China. The process of demise of this mechanism may lead the situations near to popular discontent.

#### **4.3.1.1. Pension Policy**

China's urban pension system is in crisis. The dependency ratio of retirees to workers is rising. The enterprises, which are running in loss or facing

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bankruptcy, are failing to fulfill the payment obligations of larger bulk of participating population. The efforts have been made to beef up the collection efforts and expanding the coverage beyond the traditional state and urban collective sectors. But these measures have shown little success. The enterprises refused to pay and the expansion of coverage was extremely slow. This happened because pension administration agencies lack effective collection instruments and the incentives to enforce the collection. Individuals and enterprises lack incentives to participate and make full contributions. In March 1995 the State Council issued 'The Directive on further Reform of the Enterprise Pension System'. The objective of this directive was to establish a multi-pillar pension system involving funds contributed by the state, employers, and individuals. Which is truly not according to the rationale of social justice of socialism. Under the current pension system:

First, Requires a contribution of 13 percent of payroll from firms and individuals and pays 20 percent of average wage to individuals at retirement as long as one contributes for at least 15 years.<sup>21</sup>

Second, Requires a contribution of 11 percent of wages, and pay the retiree a monthly pension of 1/120 of the balance at retirement. The rate of return is the same as the growth rate of wages. The second provision will provide him with a pension equal to 38.5 percent of his wage.<sup>22</sup>

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<sup>21</sup> Yaohui Zhao, "Perverse Pension Incentives", cited at <http://ccer.pku.edu.cn/>

<sup>22</sup> *ibid.*

The existing system does not believe in giving individuals incentives to participate. This means putting all pension contribution- from both employer and employee- into individual accounts and making sure that the investment earns competitive returns, which lacks in the existing systems. According to the established system, it gives the individual a much lower implied rate of returns on his contributions that he could earn even by investing in government bonds. Moreover, the current pension scheme provides little linkage between contribution and pension benefits. For example, a worker is entitled to 20 percent of average local wage at retirement as long as he contributes for at least 15 years.<sup>23</sup> In the economic parlance, the marginal benefit of contribution above the minimum requirement is zero. Therefore, even if a person is forced to participate, his rational action is to minimize his contributions. In case the correlations between investment and competitive returns is established, an individual would receive the full benefit from each additional yuan of contribution in to the account and would forego benefits if there is any reduction in contribution. In the name of SOEs restructuring, the interest of retired people has been overlooked. After examining the pension policy, one can find that it is mixed with faults. The economic security of the aged is at threat and consequently leading the violent reactions of workers.

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<sup>23</sup> *ibid.*



#### 4.3.1.2. End of Egalitarianism: Housing Inequality in Urban China

Housing is one another area that is severely affected by the restructuring process. Provision of providing housing for a worker was considered as a part of egalitarian social policy. According to this policy, public ownership was preferred.<sup>24</sup>

Housing reform was said as an important step to make state-owned enterprises less burdened with financial responsibilities. Urban housing was considered a non-productive sector, as investment in this sector did not generate additional values, as did industrial investment. According to the housing policy, workers and the staff concerned were given flexible options regarding their house rents. House rent was the main component of the housing policy practiced under the social welfare programme. "The core of the egalitarian housing policy was rent subsidies. In 1978, about 83 percent of rent was subsidized. Urban residents paid only 0.13 Yuan for each square meter, but the real cost was 0.78 Yuan. In 1988, 96 percent of the rent was subsidized. While urban residents still paid 0.13 Yuan per square meter, the real cost of rent had risen to 3.19 Yuan"<sup>25</sup> and as a result, the Chinese leadership in the late 80s took the decision to reform housing policy. The decision was delayed due to the lack of unanimity among leaders. Deng Xiaoping declared that people should realize that housing,

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<sup>24</sup> The current ownership structure of urban housing includes publicly owned (by governments at the central, provincial municipal town and urban district levels), work unit owned, privately owned rented and borrowed accommodations.

<sup>25</sup> Wenfang Tang, "Slow shifts from Egalitarianism to Market: Public Housing in Urban China" Cited online at <http://gb.hrichina.org/>

“traditionally viewed as welfare good, should become a commercial commodity.”<sup>26</sup>

The nation-wide programme for housing reform started in February 1985.<sup>27</sup> And the slow shift to market from egalitarianism started taking place; the words of Deng Xiaoping became the guiding line. The reforms introduced in early 1988 included, “measures to raise housing rents, to reform the housing ownership, and to promote the establishment of separate housing funds in state-owned enterprises as well as provisions charged with creating a healthy flow of funds (from wage and rent increases) into these housing funds.”<sup>28</sup> First the trial was held in Wuhan, the capital of Hubei province, the official February 1988 State Council’s authorization of housing reforms, pressed second Automobile/Dongfeng group managers to raise housing rents and to sell state enterprise housing stock. The main thrust of the housing reforms is to divest.

Along with these, there were other problems, which were responsible for making the system fake and increased the housing inequality.

- One, housing is distributed unequally among work units. Since work units are the major providers of housing, those units that can successfully allocate

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<sup>26</sup> Cited in Hannan, n. 18, pp. 53-54.

<sup>27</sup> In December 1987, Zhao Ziyang presided over a meeting of the Central Financial and Economic Leading Group that received a report from the Leading group for housing reform of the state council and he had supported January 1988 Conference on Housing Reform where ‘The Proposal for the Step-by-Step Implementation of Nationwide Urban Housing Reform’ had been approved. This programme was enacted in February 1988.

<sup>28</sup> Hannan, n.18, p. 54.

housing funds, normally those with more functional importance, can build better housing than others.

- Second is the corruption in housing distribution. In spite of the provision of administrative distribution of houses,<sup>29</sup> the system is full of faults. "Some families conceal the fact that they have already been assigned an apartment by another work unit in order to get a new one. Bribery of housing assignment committee members is common. High-ranking officials are allocated more living space and some even get an apartment at each place they work. After three job changes, the family will have three apartments for the parents and their children."<sup>30</sup>

- Third, the lack of funds caused the problems of dilapidation. The declining inflow of money made it more or less impossible task. Among the options of creating new and expanding the housing net and the repairing the old, the first one was obviously preferred because of the priority to satisfy the majority of state population.

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<sup>29</sup> The Housing is allocated on the basis of the socio-economic and political background of the concerned worker, for this matter the Score system has been introduced. The scoring system is a combination of seniority, need, merit, and political performance and policy considerations. Typically, a housing application form includes the following items with each item assigned a certain number of points: years of employment (one point for each year), years worked in this unit (three points for each year), education (one point for a junior college degree, two points for a college degree, three points for a post-graduate degree), single-child family with a certificate (three points), late marriage (three points), three-generation household (five points), household with adult children (five points), household with less than four square meters per person (seven points), returned overseas Chinese (two points), member of a minority group (two points) and veteran of military service (two points).

<sup>30</sup> Tang, no. 24

- Fourth is the housing shortage. Overcrowding became a common problem. This situation was further worsened by the low priority given to investment in housing construction.

The Housing policy has become imbalanced because of these internal ills. In this context the future will be very challenging for the government. It will be difficult to achieve the rational housing policy as far as the reform process needs further capital oriented initiatives by the state officials.

#### **4.3.1.3. Health care: Disillusionment and Disparity**

With the opening of the economy, the wave of marketization and privatization paralysed the possibility of achieving national health goals. “Early in 1949, four major national health goals were set, namely, ‘Serving the workers, and peasants’, ‘prevention-oriented policies’, ‘integrating Chinese and Western medicine’, and ‘integrating health care work and the mass movement’.”<sup>31</sup> The health care services have improved after its introduction. According to World Bank, China’s dramatic success in improving health conditions can be reflected in the rise in life expectancy from less than 40 years in 1950 to 69 years in 1982. In addition, a comprehensive insurance coverage provided by the government and state enterprises was introduced in 1975 and

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<sup>31</sup> R.C. Peng, *Medical and Health System Reform*, China Reform Collection series (1978-1991), (Dalin, 1992), p.3. Cited in Ka-Ho Mok, *Social and Political Development in Post-Reform China* (London, 2000), p. 33.

significantly improved the health care and well being of urban dwellers.<sup>32</sup> The sophistication and technological advancement was preferred to equal and wide distribution of health care services. So the transition to a market oriented approach is not without problems, but rather, has created new problems of access, equity, efficiency and costs.<sup>33</sup> The growing inequality is causing social tension among urban areas. Eighty percent of health spending goes into big city hospitals, which have spent lavishly on acquiring modern equipments such as Computerized Tomographic (CT) Scanners. In the year 1993, the country as a whole had 1,300 CT scanners and 200 Magnetic Resonance Imaging Machines, and hospitals in Beijing.<sup>34</sup> And the irony is fewer and fewer resources are devoted to preventive medicine, which perhaps accounts for the recent upsurge in hepatitis, tuberculosis and other infections and endemic diseases. Further, because of its insufficient subsidy to health-care development, hospitals were granted with the increased autonomy. The immediate result of such a policy was a steep increase in fees. Those who are wealthy alone afford the services and quality health care from these hospitals; while other sections of the population have to suffer from going to poorly maintained hospitals.

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<sup>32</sup> World Bank, *Financing Health Care: Issues and Options for China* (Washington D.C., 1997), pp. 1-2.

<sup>33</sup> V.C.W. Wong, and S.W.S. Chiu, "Health Care Reform in People's Republic of China: Strategies and social implications", in *International Journal of Public Sector Management*, 10, 1 / 2, pp. 76-92. Cited in, Ka-Ho Mok, *Social and Political Development in Post-Reform China* (London, 2000), p. 35.

<sup>34</sup> Jasper Becker, , *The Chinese* (New York, 2000), p. 241.

The social security system, which made people, used to the affordable health services. It is risky and at the same time irrational to leave such policies for the development of market. World Bank in its report *Financing Health Care: Issues and Options for China*, has stated that "...China since 1980s has been moving towards less government support for priority public health activities for all and clinical services for the poor, and greater reliance on a fee-for-service delivery system. If present trends persist, China will move into the 21<sup>st</sup> century with a poorly performing but costly health system.<sup>35</sup>

#### 4.3.2. Unemployment

Unemployed workers and surplus labourers from SOEs have become a serious economic, societal, and political challenge to Mainland China. The extreme impact of the restructuring process is the increasing unemployment in Mainland China. Since, the SOEs employed large scale of workers, and with a new wave of restructuring the number of laid off workers intensified the unemployment problem. To avoid ambiguity it is very important to explain what the present work means by the term 'Unemployment', because the Chinese term is not compatible to explain the meaning of unemployment fully. The Chinese equivalent term is 'daiye' that is waiting for employment.<sup>36</sup> But as defined by Guo, "there is no difference between waiting for work and unemployment. Waiting for work is unemployment. Insurance for waiting for work is

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<sup>35</sup> World Bank, n. 32, p. 65.

<sup>36</sup> Ka-Ho Mok, *Social and Political Development in Post-Reform China* (London, 2000), p.30.

unemployment insurance. Since 1994 the concerned department of the state officially renamed 'waiting for work insurance' as 'unemployment insurance'.<sup>37</sup> The official statistics on urban unemployment contains underestimated numbers. It covers only those unemployed people who have registered to governmental organizations of labour management. Therefore, by this definition, unemployed having not registered are normally excluded from the official count. And furthermore, *daiye* workers are not officially regarded as unemployed and thus are excluded in the statistics.

As a result of the layoffs of redundant workers and rural migration unemployment and urban poverty have increased in recent years. The new official figure of unemployed people is around 132 million.<sup>38</sup> Officials also admitted that the situation in the world's most popular nation would get worse.<sup>39</sup> However, one cannot understand China's unemployment problem by only looking at the official figures. China's current unemployment has basically two parts: one is 'open unemployment' that is those unemployed people who were treated as waiting for jobs in the past and the other is 'hidden unemployment' including both urban and rural instances. Because of the economic transition from a command economy to a market economy, open unemployment has created social concern in recent years.

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<sup>37</sup> Jinping Guo (ed.), *A Comprehensive view of China's Social Security System*, (Beijing, 1995), p. 389, Cited in Yabuki, n.14, p. 139.

<sup>38</sup> Wingfield-Hayes, Online Report at, [http://news.bbc.co.uk/1/hi/english/world/asia-pacific/newid\\_1806000/1806993.stm](http://news.bbc.co.uk/1/hi/english/world/asia-pacific/newid_1806000/1806993.stm)

<sup>39</sup> *ibid.*

**Table 4.6**  
**Urban Unemployment rate \***

Year	Unemployment Rate (%) **
1978	5.3
1980	4.9
1985	1.8
1986	2
1987	2
1988	2
1989	2.6
1990	2.5
1991	2.3
1992	2.3
1993	2.6
1994	2.8
1995	2.9
1996	3.0
1997	3.1
1998	3.1
1999	3.1
2000	3.1
2001	3.6
2002	Expected 4.5

Note: \* According to official NBS (National Bureau Statistics) figures, which do not include underemployment or the migrant population.

\*\* Urban unemployment Rate = (number of urban unemployed) / (total urban social labour force + number of urban unemployed) x 100%.

Source: State Statistical Bureau, *China Statistical Yearbook* (Various issues),  
And The China Business Review 2001.



During the reform period the official unemployment rate increased continuously. Only during the years of managerial level reforms (1985 to 1988) in the SOEs, the rate of unemployment rate was low. The adoption of methods like merging, leasing, outright sale assured definite timely growth in the unemployment rate, the years from 1989 to the present day witnessed such phenomena. During 1997 to 2000 the special effort by the state to create 16 million extra jobs per year proved quite successful. It helped state to control the growing unemployment rate. But again in the next year, it started increasing and reached 3.6 percent (2001). In the year 2002, it is expected to reach 4.5 percent. As a result of new phase of restructuring, which is under process the number of unemployed may increase rapidly in future.

The projection about the increasing unemployment varies among scholars. As an official magazine *Liao Wang* (Lookout) reported of an urban unemployment rate of 7.5%. Hong Kong's *Ming Pao*, on 8<sup>th</sup> August 1997, reported that some scholars and officials attending the 15th National Congress pointed out that urban unemployment rate had reached 8%. *Ming Pao*, 19<sup>th</sup> July 1997, quoted the Chinese official media as reporting that by the end of 1997, unemployed urban workers would amount to 60 million, which did not include workers 'temporarily laid off' by enterprises.<sup>40</sup>

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<sup>40</sup> Zhang Kai, "China going more capitalist after the 15th CCP National Congress", *October Review* Vol.24, Issue 5/6 1997.

Calling unemployed as 'waiting for job' or allowing laid-off workers to receive financial assistance and later again calling them as nominally employed, the real number of unemployed people in the Urban China remains ambiguous. By the end of 1997, according to Yu's estimate, the number of workers who were not required for production by the SOEs and actually had little or no work to do, the most radical estimate of surplus workers is up to 30 million,<sup>41</sup> even the *China Statistical Yearbook* of 1998 admits this situation.<sup>42</sup> The surplus workers are mainly concentrated in SOEs. For instance, among 11.5 million surplus workers, 7 to 8 million of them are affiliated to the SOEs.<sup>43</sup> Moreover, the number of displaced workers, or so-called *Xiagang* (off duty) workers in SOEs reached 6.3 million by the end of 1997.<sup>44</sup> Officially, at the end of 1999, there were 9,371,765 workers laid off, it seems these were counted as employed. But they were substantially unemployed, without jobs and merely waiting for the moment they become classified as unemployed or vaguely hoping for re-employment count, the registered unemployment rate is 2.7 percent. If unregistered unemployed is added, the unemployment rate rises to 5.9 percent. In a survey conducted by CASS and SSB jointly,<sup>45</sup> after calculating the all kinds of unemployment (officially registered, *daiye* workers, young job waiters, and early retirees), the total number of unemployed from urban China goes up to 13.13 percent in 1999, whereas, province level distribution of unemployed

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<sup>41</sup> Yun-Shin Yu, and Linn Fu, *Towards 21<sup>st</sup> Century: The New Concept of Employment in Mainland China* (Beijing, 1998), p. 14.

<sup>42</sup> *China Labour Statistical Yearbook 1998* (Beijing, 1998), p. 432.

<sup>43</sup> Yu, n. 41, p.14.

shows that the interior and west provinces had higher unemployment rates than the coastal provinces and that the small and middle size cities had higher unemployment rates than the large cities.<sup>46</sup> The data further shows that the unemployment among the various large and small areas (cities) varied according to the category of the unemployment. As the table shows below (4.7), in the large cities the number of *Xiagang* workers is lesser than the small cities (5.35 percent and 8.94 percent respectively). The middle urban areas are unable to provide work opportunities to workers. More than that such areas are concentrated with the heavy industries. Due to the presence of industries, the present trend of migration from the rural areas is particularly targeted these cities, which makes the problem more critical. In the case of young job-waiters the situation remains same. In large cities, the number of young job seekers is 2.80 percent, whereas, in the other small cities it is 4.52 percent, which shows that the uneven regional intensity of the unemployment.

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<sup>44</sup> *China Labour Statistical Yearbook, 1998*, p.3.

<sup>45</sup> Survey ,n. 12, various pages

<sup>46</sup> In the concerned survey the samples were collected from the cities like Beijing, Liaoning, Jiangsu, Henan, Sichuan, Gansu.

**Table 4.7**  
**Type of Unemployment in urban China by province, 1999 (%)**

Province / City	Officially registered Unemployed	Xiagang workers	Young job-seekers	Early retirees	Total
Beijing	1.95	1.84	0.97	2.60	7.36
Liaoning	0.94	5.75	6.35	3.00	16.04
Jiangsu	0.82	4.49	2.55	1.53	9.29
Henan	1.28	8.77	3.32	0.60	13.96
Sichuan	2.28	8.92	2.94	1.19	15.37
Gansu	1.55	8.79	3.38	1.84	15.56
Large cities	1.57	5.35	2.80	2.07	11.78
Small and middle-size cities	1.20	8.94	4.52	1.20	15.87
Total	1.45	6.54	3.37	1.78	13.13

Source: Survey, Institute of Economics, Chinese Academy of Social Sciences, State Statistical Bureau in China (1999) various pages.

The contradiction between the industrial output of the state enterprises and the enrollment of the workers, itself shows that there is an unsaid deep crisis of unemployment. On the backdrop of increasing privatization, the output of the SOEs is decreased rapidly. (See Table 4.8) And contrary to this the enrollment in these enterprises increased without any interruption. During these reform years, the unemployment also increased. Chinese government has to produce 16 million jobs per year to keep the unemployment rate stagnated. Because of the enterprises' financial uncertainty newly employed workers are not sure about their future. In this situation SOEs are working as processing centers for creating

unemployed crowd. Because the employed workers loss their job after a certain period on the financial background of enterprise. The relation between the decreasing output and the increasing labour force has not been kept proportionate, which assures a chain of periodic growth in unemployment.

**Table 4.8**

**Gross Industrial Output vis-à-vis Labour Force of State-owned Enterprises in selected years**

Year	Gross Output of State-Owned Enterprise (Billion Yuan)	Labour Force of SOEs (Million Workers)
1985	64.9	89.9
1986	62.3	93.3
1987	59.7	96.5
1988	56.8	99.8
1989	56.1	101.1
1990	54.6	103.5
1991	52.2	106.6
1992	48.4	108.9
1993	46.9	109.2
1994	37.3	112.1
1995	33.9	112.6

Source: Table 3.5 (Chinese Industrial Output, 1978-1999) and *China Statistical Yearbook*, 1996, various pages.

As table 4.8 shows that in the year 1985 when the enterprises industrial output was 64.9 percent, it had employed 89.9 million workers, whereas, in the year

1995 when the output went down by 50 percent, and reached 33.9 percent the enterprises had employed 22.7 million more labour force, around 112 million.

Now with some kind of confessions made by the Chinese officials it is nearly possible to reach the most probable conclusion. As National Bureau of Statistics (NBS) announced on Thursday, February 28, 2002, that the registered urban unemployment rate was 3.6 percent in 2001.<sup>47</sup> Out of 132 million jobless peoples, the number is 7 to 8 million in urban China. As Zhang Zuoji, Minister of Labour and Social Security states that the member of urban unemployment is expected to increase to eight million this year from 6.81 million in 2001.<sup>48</sup> In percentage it is expected to rise to 4.5 percent (from 3.6) this year. The chain of unemployment is will be further aggravated by China's joining of World Trade Organization (WTO). With the entry in to the WTO, China accelerated its enterprise restructuring process and more bankrupt enterprises are expected to be close down. Zhang says, "In the next few years, the number of redundant employees and unemployed people will not decrease."<sup>49</sup> So problem is further going to be more serious. Though the number of unemployed has increased geometrically mainly because of downsizing or bankruptcy of state enterprises.

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<sup>47</sup> *Peoples Daily* (Beijing), Friday, March 01, 2002

<sup>48</sup> Cited at, <http://www.china.org.cn/english/archiveen/28417.htm>

<sup>49</sup> *ibid.*

### 4.3.3. Social Stability under Threat: Rise of Workers' Protests

In the late 1980s and 1990s, reform started in the urban sector. It is only in the last few years that state enterprises have had to deal with the pressure of competition. In the new market context, the non-state enterprises have become the main driving force of the Chinese economy, and the original leading status of the SOEs has thus been lost. In contrast, under market competitions, the economic efficiency of the SOEs has been decreasing and the 'honourable' status of the state workers has been undermined. With the bankruptcy of SOEs, many workers have seen their living standards lowering. Unemployment and securing a basic income have become the most painful issues for them. For the state workers, 'labour aristocracy' and 'master' are only past glories. On the contrary, the most outstanding problem for these workers is that they have become the 'under-class labour'. As compared with the workers in other industries, state workers income is low and their jobs lack security. We have seen that the income disparity, demise of social security, decreasing pension and end of other securities are making them desperate. These disadvantages present the possibility of an increasing gap between high expectations shaped by prior gains and decreasing real social status.<sup>50</sup> Huge lay-offs have been the primary way for these industries to become profitable; still, many have gone bankrupt and been sold off. Almost every week in China, newspapers bring reports of

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<sup>50</sup> Wenfeng Tang, and W.L. Parish, and Taoqing Feng " Chinese Labour Relations in the changing work Environment", in *Journal of Contemporary China*, p. 367. Cited in Mok, n. 30, p. 89.

some kind of labour action: a demonstration demanding pensions; a railway line being blocked by angry, unpaid workers; or collective legal action against illegal employer behavior such as body searches or forcing overtime on the worker. On the one hand the managers are responsible for spreading corruption in the state sector, and on the other hand wages and pensions are reduced in the name of scarcity of the government funds. Dai Jianzhong, a sociologist at the Chinese Academy of Social Sciences (CASS) who specializes in labour relations, says “the most important reason for failure is lack of accountability in management, who use power to transfer wealth from workers to themselves.”<sup>51</sup> On July 9, 2001, 10,000 workers of the state-owned railway blocked a major railway line in Jilin province demanding unpaid wages. According to the Hong Kong based Information Center for Human Rights and Democracy, China witnessed a total of 60,000 labour protests in 1998, most involving former state employees; the following year there were 100,000.<sup>52</sup> The mere fact that the Chinese media is reporting selected cases of workers action is testament to how widespread the phenomenon has become. In recent years, scenes like these at state-owned enterprises have been repeated across China as the country moves to a market economy.

On March 20, 2002, thousands of angry laid-off workers have stepped up

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<sup>51</sup> Jiang Xueqin, “Fighting to Organize”, in *Far Eastern Economic Review* (Hong Kong), September 6, 2001, pp. 72- 75.

<sup>52</sup> *ibid.*



protests in China's industrial northeast demanding back pay and welfare benefits from state firms.<sup>53</sup> The Public Security Bureau (Police) reported that 198,000 such labour disputes took place in 1999 and the state-controlled All China Federation Of Trade Union (ACFTU) has been training thousands of experts in labour law to deal with the increasing amount of litigation.<sup>54</sup> Since March 13 about 1,000 textile workers had been protesting in Guangyuan in the South Western province of Sichuan, to demand promised compensation for job losses. Another workers protest broke out in the March of 2002, in the mining city of Fushung, and Liaoyang. As many as 80,000 idled workers in Fushung province came out on the streets.<sup>55</sup> As China shifts to a market system, hundreds of inefficient state-owned enterprises have been closed down. As industries close, a generation of the proletariat, raised under communist ideology to believe they were the 'masters' of the country, now feels at the mercy of bankrupt companies and cash-poor municipalities.

Social stability in urban China is deteriorating. The stability, which was existed prior to 1978, was different from the today's one. Chinese society is witnessing the increasing rifts and distress leading to instability. Social stability is required to any state machinery to keep itself intact, and to move further with 'just' equal economic development. The loss of social control is alarming for the

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<sup>53</sup> Reuters, "Workers step up protests in China's 'rust-belt'." Cited online at <http://sq.news.yahoo.com/reuters/asia-95902.html>

<sup>54</sup> Tim Pringle, "Industrial Unrest in China – A Labour Movement in making?" Cited online at <http://www.amrc.org.uk/alu/Alu40/014002.htm>

<sup>55</sup> Reuters, n.53.

China's leadership. Social stability cannot be maintained unless the economic development is measured on the ground. Detaining, punishing and executing the distressed cannot establish social stability.

## Chapter 5

### Conclusion

China achieved its revolution in 1949. But the eroding economic condition of the country was not a cause for celebration. China was a desperately poor country, which was devastated by decades of civil war and foreign invasion. It was Chinese leaders' urgency to bring the country back to its earlier glory. The challenge was to bring peace, stability and order in the country. This was necessary to transform China into a prosperous and powerful country.

The revolution had already provided a developmental framework for the Chinese leaders. They sought the way of 'socialist development' for achieving rapid socio-economic modernization. The Chinese revolution was different from that of the Russian; the Russian revolution was primarily urban based, while the Chinese revolution was peasant based. However, the Chinese leaders accepted Stalinist model of development for the advancement of the country. Irrespective of these basic differences with Russia, the 'soviet-model' was applied to the politics and economy of the country. The party was extended to every sphere. A complex structure of agencies for economic planning and management was established to control the whole economy.

It was not until 1978, China saw any major change in the Maoist China. The assessment shows that the basic work done by Mao was very crucial as far as the present China's development was concerned. The political and the

economic measures (Establishment of the Command Economy for integrated industrial development, and Commune system in the Agriculture) were necessary for war-ravaged China. The collectivization of the agricultural land and the rapid industrialization were essential components of the nation building.

During these efforts, Great Leap Forward Movement and the Cultural Revolution proved harmful for the country's hopes. Mao's insistence on Soviet way and on the establishment of the populist system<sup>1</sup> caused a severe stroke for the state. The 'revisionist' line was responsible for bringing drastic changes in the country's idea of the mode of development. The revisionist line of thinking emerged as a reaction to the radical policies. The line did not emerge immediately; its origin can be traced back to the 'Golden 50s'. (Pressure from the revisionists- Liu Shaoqi, Deng Xiaoping, for economic change had gradually been building up since 1957. Given the party leaders' emphasis on rapid economic growth and their intent to catch up with the world's most advanced economies as soon as possible.) The adverse of Great Leap Forward and Cultural Revolution encouraged the growth of this line. With this the rational and the pragmatic thinking started driving the wheels of the country's economy. The economic development was considered as the prime task of the reform process. A need for transition from the Maoist set-up of the country's economy was felt necessary. No more 'iron rice bowl', but 'To be rich is glorious' soon became the motto of the new developmental process. The idea of market

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<sup>1</sup> Here in the China's case the over importance to the party and repudiation of any independent interest group helped to create a populist state system.

socialism was openly accepted with care and with its (China's) own convenience. Since China has closely observed the developmental process in other socialist countries, it could introduce 'market socialism' with care and caution. To fulfill the quest for modern China, 'Second revolution' was waged. The revolution is still on. During this economic revolution, state enterprises remain no more as the commodity making machineries. Keeping enterprises dependent on the national economy was felt to be unviable option. With the introduction of the market, enterprises were made responsible for their performance. Market became the parameter to judge their performance. The growing need to survive in the market compelled state enterprises to adopt various strong measures to increase their competence in the market. The restructuring became the principal way to implement these policies. This process of restructuring in the state enterprises comprised of managerial level, commodity level, labour level and the technical level reforms.

Till now state-owned enterprises worked as main buffer between the political elites and the society. They also served the task of political and social control of the population. In the wake of the new economic atmosphere the status of the SOEs have been reduced from providing social security to merely function as an economic institution.

The results of these reforms were mixed. In the game of catching up with the West, various strategies have been tried. After the death of Mao, however, as a result of pragmatic thinking China took a turn away from ideological purity. The new way of economic development has no doubt brought far-reaching

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changes in the existing system. The economic opening made China to stand against the rich countries in the market to compete. The opening was very obvious, since the eastern European example showed its inevitability, the Chinese government chose the way of economic betterment and reinforcement of party's rule. The decision of Chinese leaders to open their economy was justified under the reason of economic development. It can be said that the new leadership gave more importance to reforms than the ideological legacies.

The economic reforms caused the weakening of the CCP's power. The reasons behind this paradox are three-fold. One, the de-danweiisation process has been the result of a series of economic reform measures in the state sector. The process is unconsciously moving further without making both masses and leaders conscious of it. On the other hand, depoliticisation and de-statisation in state-owned enterprises have taken place as part of a huge social engineering project, which has paved the way for the emergence of social and economic pluralism at the base of the state edifice, although at the apex of political power the party or the state remains strongly authoritarian. This dialectical political pattern is forging some form of authoritarian pluralism in China, a term that Prof. Scalapino has used to theorise about social transition in East Asia.<sup>2</sup> As South Korea and Taiwan have proved, economic relaxation creates pluralistic economic interests such as private concerns, autonomous entrepreneurs, and joint ventures. The freedom with regard to production, distribution, sale, profit

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<sup>2</sup> Robert Scalapino, *The Politics of Development: Perspective on Twentieth Century Asia* (Cambridge: Harvard University Press, 1989).

retention, reinvestment to producers and freedom over consumption of commodities and its prices to consumers, brought basic changes in the people's belief. The changes involuntarily made people less concerned about the state. The importance of the state, of the party was undermined due to the growing presence of market. In China, the protracted economic growth gave birth to a freedom-seeking middle class, with the growing number of such sections and their misalignment from the party ideology. In future, this may worry the party's legitimacy. The simultaneous relaxation of the control over society in pursuit of economic development is releasing a powerful force for political change.

Second, the practical policy problems involved in handling such a fundamental economic transition caused the occurrence of economic problems and later the threat for the party. The economic reform that started in China did not have any historical experience to follow. The scope of the task was immense, the policy territory was virtually unknown, the linkages between different areas of reform were complex, and the technical problems of designing new policies and institutions were difficult tasks. Even if, the restructuring process of the economy or of the state enterprises had started well before 1978, it would not have helped in bringing any viable option of development, since the problems like ambiguity of policy territory, lack of historical experience persisted.

The nature of the SOEs during these years was put under *status quo* for the political interests. The newly opened economy systematically created excess demand for material and financial resources and, combined with a 'soft budget constraint', which encouraged financial irresponsibility on the part of



enterprises. The delaying of the hard economic reform measures made the situation more critical in the 1990s. The rapid restructuring of the state-owned industries in the 1990s caused the large number of lay-offs and created a strong resentment among the workers.

Third, the unpopularity of the CCP started increasing when common people with problems such as inflation, unpaid wages, and economic insecurity forced workers to demonstrate. The restructuring of the state-owned enterprises was the immediate reason for the weakening of CCP's rule.

Both, the positive and negative outcomes of the reforms have caused worry for the ruling CCP. The government is compelled to unrestrict the individual autonomy; on the other hand the negative outcomes like utter income disparity, unemployment, diminishing social security have made the urban population to feel betrayed. The increasing unemployment, and at the same time the challenge to fulfill the increasing demands for their basic needs makes the crisis potentially catastrophic. These effects have helped in weakening the CCP's authority.

As a direct effect of the restructuring, it has been proved a poisonous factor for the CCP's control. The reform efforts at enterprise level led to sour societal consequences. The number of protests in the recent times has increased dramatically. The protesters are demanding for justice and this is new for the Chinese government. The political engagement of the people in China was very less and it restricted people to enter in the political participation. The lack of political socialization and the increasing unrest and the protests are alarming for

the Chinese state. Due to the ongoing demise of the crucial 'structure of communication' (SOEs) the situation may cause the end of CCP's rule. The increasing protests may threaten to the political system.

Although the rise of non-state sector has provided a helping hand to state in solving problems related to production, and employment, but still that is not enough. State workers who are unsatisfied with lay-off by enterprises and their uncertain future have taken to the streets, or even to the municipal government, to demonstrate and protest many times. It is entirely possible that new political groups may emerge, representing the interests of the economically and socially deprived. Strikes, sit-ins, and slow-downs are on the rise and will most probably become more organized if the tendency towards polarization continues and eventually embeds itself as a deep structural feature of Chinese society in the next century. The political consequence of heightening social and economic inequality is serious, as it seems, it is the only problem undercutting China's struggle for a better and fairer future. Economic and social polarization is a serious problem that the Chinese government has to face and tackle, as sooner rather than later, rising social unrest to be calmed and controlled.

In view of this, on 24 October 1996 the Central Committee of the CCP summoned an urgent telephone conference with the party, government and military leaders of all the provinces (districts) and municipal directly under Central administration. This conference was chaired Hu Jintao, and Li Peng, who represented the Central Committee of the CCP and the state council, gave a speech. During the conference, Li Ping pointed out that if they could not settle

the problem of unemployment well, the whole future would be adversely affected. He thus demanded that all the leaders should reorganize the work and better arrange the transformation of the enterprise system and the re-employment of unemployed workers.<sup>3</sup>

In the face of more resistance from the workers and the general populace, the 15th National Congress called for further solidarity of Party members in “defending the Party's authority, maintaining unanimity with the Party Center ideologically and politically, and assuring that the Party's line and the Center's policies can be smoothly implemented and executed.”<sup>4</sup> The party members have been asked to carry out a task of building 'democratic socialism', but the concept of creating democratic socialism still remains unclear. With social contradictions accelerating, political repressions are now seen as more necessary than before, which includes further clampdown of dissent within the Party and in society at large. Vice-minister of the Ministry of Labour and Social Security, Wang Dongjin, describes China's jobs crunch as 'grim'. The Ministry acknowledges that it must create 17 million jobs a year just to maintain its current unemployment rate.<sup>5</sup> Hu Angang, a professor at Tsinghua University in Beijing, warns that China is moving toward nothing less than ‘ an unemployment war, with people fighting for jobs that don't exist.’<sup>6</sup>

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<sup>3</sup> Luo, Bing, “The CCP Can Do Nothing Facing the Tides of Worker Unrest”, in *Cheng Ming*, 11 Cited in Ka-ho Mok, *Social and Political Development in Post-reform China* (London, 2000), pp. 89-90.

<sup>4</sup> Report ‘The 15<sup>th</sup> CCP National Congress’, Online at [www.china.org.cn](http://www.china.org.cn)

<sup>5</sup> TIME, “Workers’ Wasteland”, June 17, 2002. pp. 22-32.

<sup>6</sup> *ibid.*

China's quest to join the global economy is creating new jobs in the private sector, but it is simultaneously breeding a gigantic underclass of have-nots- citizens. Further with the joining of the WTO the situation may become more critical. China's recently shown commitment to play by WTO rules lowers trade barriers. That means more foreign companies would put extra burden on China's most vulnerable industries, such as the countries steel smelters, coal producers, and the car manufacturers. The failure in the open market, less and less bank lending and increasing deficits may further instigate factories to lay-off large number of workers. If the employment situation doesn't improve, there will be a serious impact on social stability.

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