

CHINA'S ECONOMIC REFORMS:

CAUSES OF CONTROVERSY

by Leo F. Goodstadt



On October 20, 1984, the Chinese Communist Party Central Committee (CCPCC) issued a document at the end of a plenary session which has been widely applauded by the outside world. Entitled "The Decision of the CCPCC on Reform of the Economic Structure", the statement has been interpreted as an important step forward in the rationalization of the national economy and the modernization of urban industry and commerce. Its main focus was a commitment to an overhaul of the pricing and planning systems, greater reliance on market forces and a pledge to control wage pressures while restraining inflation.¹

This document poses a number of problems when seen within the Chinese domestic political and economic context. The most striking is the absence of any detailed blueprint or timetable within which reforms should be achieved. The Decision amounted to no more than a statement of broad principles to be used in the overhaul of the country's economic administration. It might be argued that as China seeks to separate the CCP from

direct involvement in economic management, the plenary session was acting with great correctness in refraining from the publication of anything more than the basic principles to be applied in the reform process. This argument does not stand up to close examination.

The year has seen another major reform measure: the granting of extensive land-use rights to the nation's 800 million peasants. These rural reforms were set out in a CCPCC Circular which went into considerable detail and could rightly be termed a blueprint for the rural sector.² Furthermore, the CCP's General Secretary does not regard himself as in any way barred from continuous intervention in even local issues relating to specific economic development projects. A marked feature of 1984 has been the publicity given to Hu's seven provincial tours,³ which have made him far more visibly active in the economic sphere than Prime Minister Zhao Ziyang. In addition, the political rectification campaign in progress throughout the year gave Hu the opportunity to be seen as a pioneer of economic reform on a scale not matched by Prime Minister Zhao. Hu's contribution has been recorded in fields which range from economic co-operation in Southwest China and the Mongolian oil industry to the Ministry of Foreign Economic Relations and Trade.⁴

Nevertheless, in November, Hu Yaobang made it plain that the CCPCC's Decision would be left to the state administration and the enterprises to implement. Hu did not explain why the CCP preferred to stay on the sidelines, though he claimed the CCP's right to review the progress made by the reforms.⁵ The situation was subsequently made all the more difficult to fathom when the National People's Congress was given direct advice not to rush into an examination of how to apply the CCPCC's Decision overnight. "When I say that we should not discuss details now, I do not mean that we should not consider solving definite problems," declared the Congress's Chairman, "Instead, I mean that we should concentrate our energy on researching principles first and leaving specific details for the next step."⁶

Another peculiarity of the CCPCC Decision is that in certain fields, major progress had been made with reforms even before the plenary session. The most striking example is state planning. The State Council approved and circulated a comprehensive list of changes to be made in planning procedures some two weeks before the CCPCC Decision (which made no mention of the new regulations).⁷ Similarly, the State Economic Commission announced its plans for reforms in economic administration in October but ahead of the CCPCC Decision.⁸

The implication is that on some topics, reforms arouse little resistance or, possibly, opposition has already been defeated. On other issues,

seemingly, contention is still serious. The CCPCC Decision itself supports this notion about divided views for it urged that "we must not divide the cadres and masses by calling some people 'reformers' and others 'conservatives'." Hu Yaobang warned almost as soon as the plenary session concluded that the CCPCC Decision would meet with considerable opposition:

Will the current reform of the whole economic structure centring on urban reform meet with new resistance? If so, it is very likely that the resistance will come first from some comrades of the central departments and the leading organs concerned of various provinces, regions, prefectures and cities, especially the economic work departments.⁹

The area of controversy is not hard to uncover. The issue which must be grasped but which involves the greatest political risks is price reform. On the one side, the state seeks to create greater incentives for improved agricultural production as the first step towards ending China's poverty; quickly improving national living standards; and guaranteeing adequate supplies for the rapid expansion of light industry. The principal incentive since 1978 has been higher prices so that improved personal and family productivity in the farm sector translates into higher personal incomes from farming. The impact of this policy on the state budget has been adverse. As Finance Minister Wang Bingqian told the National People's Congress in May, the budget deficit for 1983 was RMB 4,346 million instead of RMB 3,000 million as originally forecast mainly because "the bumper harvest [entailed] paying an additional RMB 3,470 million as price subsidies for above-quota purchases".¹⁰ In other words, the current agricultural support system operates to create maximum strain on state budgets when a bumper harvest is reaped,¹¹ and the 1984 harvest is reckoned to be above the previous year's levels.

But the other side to the argument is the state's attempt to prevent higher farm procurement prices from affecting urban living standards. The Government has accepted a responsibility for stabilizing the cost of living for urban residents through lavish subsidies, mainly on food but also on such items as housing and heating. The costs of this urban assistance are large and growing. A leading economist has stated that in 1978, subsidies cost the state RMB 16,000 million, equivalent to 14 per cent of state revenues. They subsequently increased at an annual average rate of 28 per cent until 1982 when they totalled RMB 43 billion, equivalent to 38 per cent of state revenues. The economist also showed why this burden must be regarded as close to intolerable. While the economy overall has grown, "there has not been any major improvement in the situation of poor economic results". His view was that the country's economic expansion had not been fast enough in recent years to accommodate the mounting subsidy payments.¹²

Why not launch an immediate drive for the radical reform of prices to eliminate wasteful or unnecessary subsidy payments either to producers or consumers? This subject was reviewed authoritatively during 1984. The most important point made by the author was that the price reforms introduced for agriculture in 1979 were far from being the universal successes which is usually claimed. He argued that the area under cotton was boosted excessively because of incorrect pricing assumptions, while output of rice declined inordinately compared with wheat for the same reason. The same article made the persuasive political and social point that society contains low-wage earners who would be badly hit by any price rises, together with increasing numbers of such groups as the aged who are not protected against inflation.¹³

The situation facing the CCPCC plenary session and the Chinese leadership as a whole can be easily summarised on the basis of the economists' evidence. If prices are not adjusted and subsidies reduced, the budget will continue to face serious deficits. In theory, farmers could be forced to accept lower prices but would they maintain the improved outputs achieved in recent years if their real incomes fell? And in theory, the urban population could be called on to pay prices closer to the true cost of production of food and heating (and of construction and maintenance for housing), but could society tolerate such a reduction in living standards for its most vulnerable urban groups? Or does the nation accept a measure of inflation and allow both prices and wages to rise? Could China, with its traditional hostility towards inflation, accept such a danger? The CCPCC Decision decided against both price and wage increases which would start off an inflationary cycle.

Instead, the CCPCC looked for a solution in terms of improved productivity. The idea is that prices and markets are signals to producers about how they should act. If the price of an input rises, the efficient factory will reduce its use of that item and switch to another which has become relatively cheaper or seek to use the more expensive input more efficiently. Thus, the price of inputs could be raised without pushing up total costs of production by the same amount, provided the management can improve the plant's efficiency. Similarly, if the price of a commodity goes up on the market, producers should step up their output, while at the same time, the purchasers or consumers ought to act rationally and reduce their demand for the more expensive product. Prices and markets assist rational adjustments by producers and consumers, a point made quite strongly in the CCPCC Decision.

It is at this point, however, that the real controversy arises. The CCPCC Decision pointed out that "the various aspects of the reform in the economic structure, including planning and wage systems, depend to a large



extent on reform of the price system". If prices are not reformed, the efficient will not be rewarded and the individual peasant and worker will have no direct personal incentive to improve performance. Unfortunately, the entire economy is built on a system of irrational price.

Piecemeal reform can produce negative results (as agriculture's experience indicates). The plant which makes the most money does not necessarily have the highest efficiency. The enterprise may have gained considerable advantages in the past if its output was a national priority so that it enjoyed subsidised plant and equipment, cheap power and raw materials and good access to roads and other communication facilities.

To raise the cost of electricity or some other input today does not remove the advantage which this plant enjoys since it built up its production facilities and its working capital and financial reserves when specially favoured in the past.

This situation is likely to become all the more serious in 1985 when most new industrial projects will be financed with bank loans on which interest will have to be paid and whose repayment must be guaranteed to the banks. Hitherto, such investment funds were provided by the state as free budget allocations. Thus, price adjustments will not correct the irrationalities caused through past policies, especially when it comes to the capital structure and resources of an enterprise.¹⁴

A second consideration is that if prices are adjusted, they may create problems which managers will find virtually impossible to overcome. The most obvious example is the price of coal compared with oil. Both coal and oil have been grossly under-priced compared with their international or free market levels.¹⁵ China is short of energy, and the state has a campaign to conserve as much fuel as possible. When fuel is sold to the domestic market at a loss, as coal is, the public has no incentive to save coal (other than moral suasion). When fuel is cheaper than on world markets, the consumers in China have a direct encouragement to use oil and coal more lavishly than their foreign counterparts. But once a factory is built

or a heating system installed on the basis of low-cost fuels, a major re-investment is required if fuel prices are raised.

In simple terms, a rise in the costs of key inputs may require expensive new equipment to respond to the new cost structure. And, of course, this point applies to the labour market with equal validity. Labour is cheap in China because the urban worker is heavily subsidised by the state. If the subsidies were slashed and enterprises had to pay a proper market wage, labour-intensive operations in China would find their profitability under severe pressure.

A final consideration is the will of China's economic management to accept the competition which price reforms would bring and which the CCPCC Decision endorsed. The evidence on this score is to be found in the response to competition from small rural enterprises which started to mushroom after 1978. On the whole, the Government has preferred to protect existing, large enterprises from the smaller producer, and official complaints of unfair competition have been heard in such different



industries as tobacco, silk, clothing and machine tools. The main charges against the rural enterprises were that they were able to obtain raw materials more efficiently than the urban enterprises, and that they undersold their urban rivals. As a result, efforts were made to restrict the freedom of the rural enterprises.¹⁷ Once an urban factory is built and a work force employed, the state or the local administration has a vested interest in keeping the plant alive and well. It wants a return on its original investment; it needs its share of taxes and profits generated by the plant; its constituents want the jobs it offers.

Even a brief survey of the economic and technical factors which influence the investment and production decisions of China's managers indicates that price changes are extremely complex. From a political viewpoint, they are not particularly easy to handle. In a country which was not wedded to Marxism-Leninism-Mao Zedong Thought, the remedy would be to replace the planning system and the price controls with free markets, as many Western countries did successfully after their reconstruction programmes following World War II. The CCPCC Decision insisted on a planned economy to "avoid the anarchy of production and cyclical crises characteristic of capitalist society". What has not been revealed is how a communist party's central planning can be combined with the market rationality of free competition. This dilemma must generate debate in China, just as it has created controversy in the industrialised economies for half a century.

Notes

1. NCNA 20 Oct 84.
2. NCNA 11 June 84.
3. NCNA 29 Oct 84.
4. Beijing Radio Service 28 Oct 84; NCNA 28 Oct 84; NCNA 29 Aug 84.
5. NCNA 5 Nov 84.
6. Vide Peng Zhen's speech NCNA 15 Nov 84.
7. NCNA 9 Oct 84.
8. Zhou Zhaoxian & Fei Qiang NCNA 15 Oct 84.
9. NCNA 28 Oct 84.
10. NCNA 1 June 84.
11. China Prices Society Forum Jiage Lilun yu Shijian 3/1982 20 May 82.
12. Mao Tiangqi Jingji Yanjiu 9/1984 20 Sep 84.
13. Zuo Mu Jingji Yanjiu 6/1984 20 June 84.
14. Sun Xuewen Jingji Lilun yu Jingji Guanli 3/1982; Guangzhou Ribao 19 May 83. One proposed solution is to use taxes as an equaliser. Song Yifeng Renmin Ribao 9 Feb 84.
15. Shijie Jingji Daobao 13 Dec 82.
16. Sue Muqiao Beijing Ribao 11 July 84.
17. Jingji Ribao 8 July 83; Sichuan Ribao 20 Apr 82; Shandong Branch People's Bank Zhongguo Jinrong 6/1983; Sun Xiaoliang Jingji Guanli 1/1983.