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Intereconomics

*Suggested Citation:* Bohnet, Armin (1988) : The changing economic order in China: Trends and limitations, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 23, Iss. 3, pp. 132-137,  
<https://doi.org/10.1007/BF02925152>

This Version is available at:

<https://hdl.handle.net/10419/140132>

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Armin Bohnet\*

# The Changing Economic Order in China

## Trends and Limitations

*Far-reaching changes in the People's Republic of China's economic and social policy have been decided and carried out since 1978. The following article analyses a number of selected aspects of the economic order to illustrate the direction the reforms are taking and the limitations to which they are subject.*

China's internal economic and social reforms have been accompanied by a rapid opening towards the outside world. The resolutions of the 13th Party Conference in October 1987 and the decisions taken at the National People's Congress that closed recently have dispelled most doubts about whether China will continue to pursue the course of pragmatic reform. As a result of these changes, the People's Republic of China is now a significant economic force in the Pacific basin and a nation that is a factor in world politics. It may be assumed that China's position in the family of nations will continue to strengthen.

It is impossible to describe and assess all the areas of economic reform within the scope of a general article. A few selected areas of the economic order will therefore be analysed to illustrate the direction the reforms are taking in China and the limitations to which they are subject. Emphasis will be placed on:

- changes of organisation and personnel within the Party and the Government;
- the reform of property and control rights in the urban economy;
- labour "market" problems and the beginnings of reform;
- a number of trends in agriculture;
- the housing problem.

The problem of the party and the government being parallel organisations and intertwined was recognised earlier in China than in any other socialist country, but it has still not been solved. It therefore comes as no

surprise to find a Chinese newspaper, the Guangming Daily, calling recently for greater efforts to achieve a clear separation of functions between the party and the government. It was no longer acceptable, the paper declared, that senior civil servants bore formal responsibility but in fact the party unit took the decisions. What is surprising, however, is that the separation of powers among the legislature, executive and judiciary in western democracies should be mentioned as a possible model for reform.

The unsatisfactory situation is to be resolved by two measures; first, a clear separation of powers between party and executive is to be achieved in that the party will confine itself to making important personnel decisions and laying down organisational guidelines, and secondly constant attention will continue to be paid to reducing the cumulation of party and governmental offices by a single person. Indeed, there is still scope for progress in this area.

### Reorganisation of Governmental Bodies

The amalgamation of ministries and commissions and the establishment of new reform bodies constitutes a second important change.

As the responsible member of the State Council, Song Ping, announced recently before the National People's Congress, 14 ministries are to be abolished and 10 new ministries and commissions formed. This will be accompanied by the removal of a total of 10,000 posts, around 20% of the current body of officials. The amalgamation of the State Economic Commission and the State Planning Commission and the reduction of their staff from 4,000 to 1,500 seems particularly

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noteworthy. The authorities justify the amalgamation on the grounds that detailed central planning of production has been largely abolished, so that the State Economic Commission no longer needs to implement the plan by means of directives. The Commission's loss of importance is correspondingly large.

In contrast, the plan to form a mammoth transport ministry by merging the Ministry of Railroads, the Ministry of Telecommunications and the state airline CAAC appears to have been shelved for the time being, although it is not yet clear why the amalgamation did not go ahead.

The Commission for the Restructuring of the Economic System, which was set up as recently as 1982, is thought to play a particularly significant role in the development of economic reforms over the medium term. The Commission, to which is attached a research institute staffed by highly qualified young graduates, is regarded by insiders as a think tank and the most important source of advice to the Party and the Government on economic reform measures. A further sign of the Commission's importance is the fact that after the close of the 7th National People's Congress Li Peng resigned as Chairman of the State Education Commission to head the Structural Reform Commission.

As an outside observer, one may ask how the emphasis constantly laid on decentralisation intentions and measures can be reconciled with the amalgamation of a series of ministries into so-called commissions with nationwide powers. Will this not create new bureaucracies with even greater central power? The author sees no contradiction here, providing the commissions' functions are narrowed to taking decisions of principle and monitoring compliance and the number of ministry officials is significantly cut.

This appears to have occurred when the State Education Commission was set up several years ago. There had previously been a series of ministries, which were each responsible for a few universities and often interfered even in their day-to-day activities. One consequence of this was a lack of uniform rules for courses and the assessment of university examinations. That has now changed; the SEC is responsible only for granting the right to establish training courses and to bestow university degrees, such as master's degrees or doctorates, and some progress has also been made towards uniform qualification standards. At the same time, the individual universities could be given greater freedom to settle detailed questions.

Significant changes have also been made in the area of personnel, the most important aspects being a reduction in the average age of state officials, the replacement of bureaucrats by technocrats and the replacement of reform opponents by reform advocates.

### **Recognition of Individual and Private Property**

In accordance with Marxist doctrine, socialist countries believed for decades that state ownership of the means of production was the most desirable form of ownership. The People's Republic of China was one of the first socialist countries to move away from this dogma. A distinction has to be made here between two lines of development: one restored the recognition of private ownership of means of production and the other shifted the powers of decision in state enterprises from the bureaucracy to the plant management.

As part of the first line of development, it is now accepted in China that it can be sensible and useful to have other forms of ownership alongside state ownership. Whereas co-operative ownership was already known in Hungary, the German Democratic Republic and the Soviet Union as a concrete form of social ownership, especially in agriculture, and to that extent was nothing new, the same is not true of individual ownership, let alone private ownership. China has permitted individual ownership of means of production since the end of the Cultural Revolution and has afforded it the protection of the state; since last year private ownership has also been allowed and embodied in the constitution.

In mid-1987 there were just under 15 million individual enterprises, which may have no more than seven employees, and least 70,000 private enterprises employing around 1.2 million workers in the urban economy. Private enterprises not infrequently have several hundred employees. They may have been set up originally as individual enterprises, but there are also joint stock companies and an increasing number of private enterprises that came into being as a result of the sale or lease of former state enterprises to private individuals.

That there are not already many more private enterprises is probably due mainly to the fact that private ownership had no protection in law, workers in this sector have no social security and there are still many obstacles that have been built up by the local authorities. Moreover, for decades the private ownership of means of production was derided as a capitalist relic and many people still suspect that the same could happen again. Small wonder therefore that so far very few workers in

state enterprises have switched to the private sector. Until now, the advantages of a guaranteed job and social security provided by the plant were clearly more highly esteemed than the uncertain chance of an above-average income.

Party and Government organs have now recognised these barriers and begun to dismantle them. The constitutional amendment passed at this year's session of the People's Congress, which expressly places private enterprise under the protection of the state, appears to be particularly significant. Since in future state enterprises will not be able to give their workers such strong job and income guarantees as in the past, the trend towards an expansion of private enterprise may accelerate in the next few years.

Important changes in land utilisation are also beginning to emerge. Land may still not be bought and hence not sold either, but in future it should be possible to acquire land utilisation rights for periods of between 20 and 50 years and even up to 90 years for housing purposes and to transfer these rights to other persons, a point that is particularly important. Buildings on rented land may be sold freely. The author considers that a significant process of change has been initiated here.

### **Redistribution of Control Rights**

The second line of development in the reform of ownership law consists in the fact that within the framework of state ownership of means of production a sharp distinction will be drawn in future between property rights and the right of control. Whereas the state will retain property rights – whatever one understands by that term – the right to operate the plant will be transferred to its management and workers. This stratagem preserves formal state ownership, but at the same time it is now possible gradually to free production in state enterprises from central planning and guidance. Henceforth enterprises will have responsibility for their products, for earning sufficient financial resources and for expanding their production capacity.

Initially their independence and responsibility for their own actions will admittedly still be controlled by the state; at least that is the impression given by the “provisional order on the contract system of state industrial enterprises” issued on 28th February of this year. The system of directives from the top will be abolished, but factories will conclude contracts with the state or the responsible authorities in order to ensure that their activities do not stray too far from the objectives of the state. The plant manager will be

responsible for fulfilling the contract. He will no longer be appointed by the relevant minister; instead, the post will be advertised and the manager will be selected by a committee of officials from the relevant state body and representatives of the plant's workers. Applicants must submit an enterprise plan promising to achieve the following business objectives:

- to earn a certain minimum profit,
- to transfer a certain minimum tax to the state,
- to invest a minimum amount in reorganising and expanding the production facilities,
- to pay wages and bonuses in accordance with state regulations and the financial situation of the enterprise.

The candidate who presents the most favourable and credible contract proposal should obtain the post of plant manager. Nevertheless, one must remain a little sceptical whether it will be possible to achieve the desired results with such a system. China's reformers justify taking only half a step forwards on the grounds that the alternative market economy is not yet mature owing to continuing price distortions.

### **Labour “Market” Problems and the Beginnings of Reform**

Until only a few years ago there was no labour market in China. Schoolleavers were mostly absorbed into their parents' unit. University graduates were allocated to regions and enterprises according to the plans of the State Planning Commission. Once engaged, the worker was guaranteed a job for life, but on the other hand it was almost impossible for him to transfer to another unit.

One consequence of these arrangements is that even today unemployment exists alongside labour shortages. Many enterprises are seriously overmanned. The China Daily of 18th March 1988 reported that there were 15 million surplus workers in state enterprises, a situation that is also termed “unemployment behind the factory gates”. Overmanning is costly and has a disastrous effect on the motivation of workers in these plants. The problem is acute in mechanical engineering, but is also to be found in many other state enterprises. Since the workers generally have life-long contracts of employment, it is practically impossible to dismiss them. Instead, if there is a shortage of work they are assigned a task of some kind or they must themselves find a job to do, such as selling sweets. In the final analysis this is a costly way of proceeding and inefficient from the point of view of the plant.

On the other hand, there are areas in which there is a shortage of labour, such as street cleaners and bus and tram drivers in the cities. There are many reasons for this, but not infrequently it is a question of low wages, an unsatisfactory working environment or work that is unusually hard.

A second consequence of the current labour arrangements is the heavy burden of social costs borne by enterprises. Since China does not yet have a functional state system of social security and welfare, state enterprises must bear a heavy burden of supporting old people, caring for the sick, educating children, and so forth.<sup>1</sup> Such costs are far higher than in other western or eastern bloc countries and make it difficult for enterprises to use their financial resources in a profit-oriented way.

China still has a long way to go before it has efficient labour markets. The ties binding workers to the danweis, which are mostly production or administrative units, are still so strong that a worker wishing to leave his unit may do so only with the agreement of the unit itself. He has become the property of the unit, so to speak. This makes it extremely difficult for a good skilled worker to change jobs. If he does succeed, the unit to which he transfers must often pay compensation. Skilled workers are bought and sold in the same way as professional football players in the West.

So-called "labour exchange centres" have been set up in some cities to make job changes easier and improve the matching of supply and demand. They record the particulars of job-seekers or those trying to change jobs and fill vacancies if possible. However, the fundamental problem of labour inflexibility, which is inherent to the system, cannot be solved in this way.

One arrangement that may prove useful over the medium term and perhaps longer is the possibility for enterprises to conclude fixed-term contracts of employment lasting one, two or more years. If the enterprise is satisfied with the worker's performance the contract can be renewed. If not, or if his skills are no longer required, the worker will not be re-employed. In mid-1987 there were just under 6 million fixed-term workers, less than 5% of the 130 million workers employed in state enterprises. The greater flexibility from the point of view of the plant has to be set against the problem that these workers are treated much worse than life-long workers. They earn lower wages, are

assigned to difficult jobs and often endure miserable housing conditions.

A third way of increasing labour flexibility consists in revising the system of rewards. Whereas hitherto grading has been determined according to seniority and qualifications (such as diplomas, number of foreign languages, etc.), the seniority principle will now increasingly recede into the background. At the same time, payment by piece rates, time wages, job-related supplements and result-oriented wages for special assignments will increase in importance.

The chances of a rapid improvement in the labour market situation are not rated very highly by Chinese experts. The traditional arrangements are likely to sustain inflexibility and immobility for many years to come. To that extent, the suggestion made by some Chinese economists that a modicum of unemployment should be allowed in order to encourage workers employed in the enterprises to work harder would be of only limited benefit, for "it is more difficult to fire a worker in China than it is to enter the kingdom of heaven".

### Trends in Agriculture

Agricultural output increased substantially after the introduction of the system of "self-responsibility" in the early eighties, but the surge of motivation among farmers was followed from 1985 onwards by a period of falling grain production and later also a decline in the output of pigmeat. The reason was not that farmers had become less hard-working, but that they had shifted to activities that promised higher incomes, such as the growing of fruit and vegetables, the transportation of produce from the country to the towns and trade in food products. This trend was reinforced by the fact that from 1985 onwards the prices of industrial articles and agricultural equipment had again risen much faster than the buying-in prices of agricultural produce. The result was a decline in farm incomes and a corresponding fall in motivation.

Another problem was becoming increasingly evident during these years, namely that farmers were pursuing a strategy of short-term profit maximisation. Since the question of land ownership had not been settled clearly enough and there was a possibility that the state could appropriate their land again, farmers carried out little investment. Irrigation systems fell increasingly into disrepair, more and more farm land was converted into building land and production techniques were not improved. The result was high production costs and a fall in the output of important agricultural products. It is

<sup>1</sup> Further examples are factory meals, kindergartens, heating costs and additional payments to support needy families and individuals.

therefore no surprise that China can no longer export grain as it did in 1985, but must import it in large quantities.

The Chinese Government has now recognised the seriousness of the problems in agriculture and introduced a package of measures to resolve them. Whether they are successful will largely determine whether in future the population can be guaranteed a minimum supply of grain and rice and whether rural development will provide the necessary stimulus for rapid growth in the urban economy. The planned measures comprise:

- an improvement in farmers' incomes by raising the buying-in price of grain and rice. At the same time households are to receive income supplements so that their cost of living will not rise too rapidly;
- incentives to raise contractual production volumes of grain and rice by supplying farmers with scarce production inputs;
- an increase in state finance for agricultural investment, especially to repair and extend the irrigation system;
- regulation of the supply of grain by means of state purchases of surpluses and the release of grain to the market in years of poor harvests;

a reform of land ownership to guarantee farmers the use of the land over the long term and to permit the creation of larger production units by renting land and employing paid labour.

The situation can be expected to improve only gradually, since agriculture is inherently slow to react. The Chinese would be advised to learn from the mistakes of the West, especially the EC, and to avoid as many of them as possible.

### The Housing Problem

To provide the Chinese population with adequate living space is one of the urgent objectives of Chinese economic policy. Living conditions have improved significantly in rural areas in recent years, at least as far as size of dwelling is concerned, largely as a result of action by farmers themselves, but the situation is still bad in the towns. For example, the average inhabitant of Shanghai must make do with 4 square metres of living space and the standard of apartments is often still very low. The housing situation in most other cities is not much better.

The seriousness of the housing problem is due partly to the rapid population growth in the fifties and sixties, but also to a fundamentally flawed housing policy. It began with rents, in other words the price of living

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Large octavo,  
236 pages, 1986,  
price paperbound DM 46,-  
ISBN 3 87895 302 X

VERLAG WELTARCHIV GmbH – Hamburg

space. While at the beginning of the fifties rents were still 0.4 yuan per square metre of space, in the mid-fifties they were down to 0.13 yuan, where they remained until the eighties. Housing costs therefore fell from 10% of family income to 1-2%. This has led to a situation in which families spend less on rent than on tea and cigarettes, according to the China Daily of 19th March 1988. Rents have therefore also lost their possible function as a means of rationing living space among families. Hence accommodation had and still has to be distributed according to other criteria. What makes the situation even worse is that the money families save on rent is spent on non-durable and semi-durable consumer goods, leading to shortages of such articles and fuelling inflation.

Since the nationalisation of private dwellings in 1956 housing has been allocated by state agencies or by the units. Apartments were allotted not only according to family size but also often according to the principle of merit; in recognition of their services to society, officials or cadres were therefore often given priority over ordinary citizens and allocated larger apartments. Unfairness in the distribution of living space was and still is an unavoidable consequence. What is more, rents are far from sufficient to cover the cost of building and maintaining apartments, so that the state must pay substantial subsidies. Since these are paid according to floor area and not according to need, families with the largest apartments benefit most from state aid. In certain circumstances that too can prove very unjust.

What is the situation now with regard to the supply of housing? Residential building has been stepped up considerably since 1979. It is claimed that 1.3 billion square metres of new housing has been constructed. Set in relation to the urban population of around 200 million, this would mean an increase of 6.5 square metres per person, or an extra 26 square metres for a family of four, and would signify that the per capita living space had more than doubled in less than 10 years, for in 1978 housing provision averaged just 3.6 square metres per person. However, there are grounds for doubting whether the housing situation has really improved so dramatically.

There have been no private initiatives for the erection of housing in China's cities so far. That is understandable, for they were simply not permitted. The maintenance of the housing stock is still appalling. Why should people take care of their apartments or renovate them when everything belongs to the state?

The continuing housing shortage and the heavy burden on the state budget caused by expenditure on

new building and the maintenance of the existing stock have increased pressure for a reform of the housing sector. The stated objective is to introduce a commercialised, self-supporting housing sector. To that end, tenants would initially pay a rent "appropriate to the cost", which would probably be at least ten times the current rent. To compensate for the increased expenditure households would initially receive coupons with which to pay part of the rent. Later they would be paid a wage supplement which they would have to spend primarily on rent.

At a later stage, it is intended that gradually as many families as possible buy the apartment they occupy. It is also to be possible to buy apartments rented by other families, in which case the occupiers would have to be provided with an alternative apartment. Purchasers would have to make a downpayment of at least 30% of the purchase price and could finance the remaining 70% by borrowing for a maximum term of 10 years. As long as high subsidies are paid for rented accommodation, however, there is likely to be little incentive for families to purchase their own apartment.

Another method of commercialisation in the housing field would be to sell old city centre apartments to enterprises for use as business premises. This would generate relatively large budget revenues, which could then be used to build apartments on the outskirts.

Finally, there are plans to develop a property market. For that purpose provision has been made for land utilisation rights granted by the state to enterprises or individuals to be transferable to other parties.

## Conclusions

China's economy and society are in the midst of a period of change. Even regular visitors to China are constantly surprised by new developments. The variety of opinions expressed in the press, on the radio and in academic publications fascinates the observer of the Chinese scene.

Of course, there are still unsolved problems as well as a series of important advances. Price reform is being pursued very cautiously. The pool of qualified managers is still very small. It is proving a slow task dismantling outdated structures in state enterprises and the bureaucracy. Further improvement is still possible in university education. Not least, the opening-up of China's economy to the outside world is still not complete. Further measures will therefore be necessary if China is not to come to a standstill half-way to its goal.