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Economic Transitions to Market Economy

_____A comparative study on economic reform
proposals in China and the former Soviet Union

(Submitted for Ph.D degree in University of Glasgow)

Wei Liu

**Institute of Russian and East European Studies
Faculty of Social Sciences, University of Glasgow**

June, 1994

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AVAILABLE

Poor text in the original thesis.

Some text bound close to the spine.

Some images distorted

To My Husband

Abstract

The 1980s and 1990s are historical periods of economic reforms in both China and the former Soviet Union. Comparative study of principal proposals of economic reform and transformation in the two countries in this period is the subject of this thesis. There are five main chapters excluding the introduction. Chapter 2 is the theoretical framework of the thesis which is based on essential concepts of Comparative Economic System. Before the main theme began, primary economic problems and difficulties in pre-reform periods in China and the former Soviet Union were discussed in Chapter 3. So was a brief review of reform efforts in the past in the two countries.

In Chapter 4, major proposals of economic reform in Chinese economy from late 1978 till 1992 were studied. Of these included reform measures in the rural economy, the opening up policy, state-owned enterprises reform, new policy for non-state sector and comprehensive plans after 1985. Chapter 5 discussed the 1987 reform package, the 1990 reform plans including Presidential Plan and Shatalin Plan. A brief summary of the Russian reform plan in 1991 was also done in this chapter.

Chapter 6 is the concluding part of the thesis. The author compared in details the two cases and drawn conclusions as the following: (a) Both Chinese and Soviet reformers designed the transformation from centralised planning control to decentralised market-oriented economy; (b) The structures of the existing economic system, i.e, decision-making, information, motivation and ownership structures, required various degrees of alteration in the two countries. Soviet reformers called for massive destatisation and privatisation of the state-owned undertakings, while China insisted on a structure with predominant state-owned enterprises;(c) The economic reforms strategies in the two countries are different. In general China took a muddle-through, evolutionary, partial and moderate way, while Soviet reformers chose a theory-led, revolutionary, partial and radical road to implement the transformation;

Acknowledgement

Economic transformation in ex-planned or Soviet-type economies is a difficult subject. Comparative studies of two countries under this subject is more difficult. It is, therefore, the first thing I 'd like to do, when I finish my Ph.D thesis, to give my heartfelt thanks to all people who have helped me in one way or another during my over three years study in the Institute of Soviet and East European Studies, University of Glasgow, from 1989 till now.

One of them that I must mention first is Prof.W.V.Wallace, the former director of the Institute. It is not only because for what he has done for me as my supervisor, but also for all his kindness and help to get the financial support from various sources to support my study in this country for three years, which covered my tuition fee and living cost as an overseas student. Thanks to his effort, my dream of studying for Ph.D in this country could come true. I also must be grateful to Prof. Wallace for his continuing concern and crucial help to bring my husband to Britain after our over two years separation since I came to Britain.

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Chapter 1: Introduction

Since the 1980s the world has been witnessing tremendous and dramatic changes taking place in the former socialist countries, or to put it in economic terms, the centrally planned economies (CPEs). The political changes have been particularly outstanding. Here is a cartoon describing vividly how fast are things moved in the former Soviet Union in a year!



From the U.S. daily Dayton Daily News.

(I)

Starting from earlier reforms in their economies, political and social changes have taken place one by one in China, the East European countries, and the former Soviet Union in the period of a few years. In China, the communist government had to use guns and tanks to suppress the largest demonstrations that have ever happened in the history of the People's Republic. As the result of political pressures in East Europe and the former Soviet Union, the "Berlin Wall" collapsed and East Germany vanished as a country. The former Soviet Union was replaced by the Commonwealth of Independent States. Fifteen new sovereign states were born. The changes in the former socialist countries have

been so fundamental and forceful, at least on the surface, that communism is said to be disappearing in a majority of them. Under the new political regimes, the centrally planned economies have been pushed aside in favour of a transition to private market economies. Socialist principles have suspended, if not yet denied, due to alterations in politics. In a word, the world has been rocked by the rapid deviation from communism and simultaneously from centrally planned economic systems.

It is clear that the relentless but only partly successful movement towards economic reform in Eastern Europe, China and the former Soviet Union has entered a new era: i.e., the transformation of a centrally planned economy into a market-oriented one, instead of moderate restructuring within the framework of the existing system. People are now more concerned about how to effect this transformation than about why it was inevitable. Of course, the practicalities of economic transition in these former socialist economies has raised a number of interesting but challenging questions for the student of comparative economic systems (Campbell 1990). For instance, how do you monitor and analyse the process of transformation in the CPEs, the trend, the strategies, the speed and so on? But before this question can be answered, one must know, or be able to predict, the destination of the transition and the things that must be done in order to reach a conclusion. However, in this respect, we find ourselves still poorly equipped with theoretical tools as well as empirical data. First of all, we lack a conceptual basis and an analytical framework for our job. For example, it is fully understood that economic transition in the CPEs is going towards the destination of a market-oriented economy, which would entirely dismantle both the command economy and state ownership. However, what type of market economy will be created? And is there any adequate theoretical model that could be copied by the former planned economies? It is not inaccurate to say that there has

never actually been one single model of a market economy in the world. In terms of government intervention, the American economy differs from Britain, where the government takes more responsibility for the welfare of the population. In Japan where “the bureaucracy has maintained and uses skillfully its authority over the private sector” (Marer, 1991). Needless to say, a developed market economy and a developing market economy show sharp differences as well. So what will be the destination of the ongoing transition in CPEs? Moreover, the development of advanced market economies in the west has gone through various stages with different features. Which stage and what feature should or can the former planned economies follow? While Kornai advocated learning from the very beginning, i.e., from the period of primitive accumulation of capital (Kornai, 1990), there are also suggestions of following the modern regulated market economy (Wu, 1991). But it seemed that reformers in the former CPEs, in China and the former Soviet Union in particular, were more concerned with the essential features that all market economies share than the characteristics of various models of it.

Nevertheless, research on this subject could be of great significance and value in both an academic and a practical sense. Transition to a centrally planned economy in the countries involved was primarily a process of political and military struggle which the communist parties won. Now, the transition the other way round has to be a matter of economics, reasoning quite apart from the inevitable political and social changes. Economic analysis would also be enriched in its scope if the study of transition from the one economy to the other could draw some relevant conclusions. This is because there has been no adequate conceptual framework for understanding, let alone guiding such a transition, in Western mainstream economics, nor in socialist or Marxist economics. What is more significant here is the fact that operational plans are desperately required in the former planned economies for a smoother

and more successful transition, because the transformation is such an unprecedented process in economic history that there is no theory or experience for reference and guidance. So, empirical studies of the ongoing process in individual countries should certainly provide helpful information and lessons for policymakers in all the countries involved. It is, therefore, an adventure worth trying.

However, things are not so bad as to suggest that the present research is not feasible, despite the undoubted difficulties. Economic reform and transformation in centrally planned economies has attracted the research interests of economists for decades, both in the West and in the East. It became a relevant academic and practical subject in Western economics because the existence, operation and alteration of the Soviet-type planned economy was a challenge to mainstream market thinking. According to market theory, it is not possible for a centrally planned economy to work at all (Bornstein 1969). Although centrally planned economies were established by communist revolutions in the former Soviet Union, Eastern Europe and China, their operation became more and more an issue of economic controversial as time went on. Some economists contributed to the study of the mechanisms in the Soviet-type economy within the framework of mainstream Western analysis and concepts. Comparisons between a market economy and a planned economy, in principle and practice, have been developed in recent years. As a result, a new branch of economics has been established, i.e., comparative economic systems. In this discipline, the elements of an economic system, the concepts of altering it, its major differences with other systems and related issues are discussed, though the achievements so far have not been satisfactory enough. The comparative method, cases studies on individual countries, and qualitative analysis are applied in addition to the normal means of economic analysis. The conceptual basis and research methodology of this thesis is based on this discipline.

(II)

Of course, the author is not so ambitious as to cover a wide range of research in terms of the number of cases and topics in relation to the transition of the centrally planned economies. That sort of research is practically impossible. Instead, she has chosen China and the former Soviet Union as the two cases for a comparative study of the issues of economic reform proposals in the period from late 1970s, in China's case, and mid-1980s in the Soviet case, up until the early 1990s.

It is needless to stress that comparative study plays a very important role in case studies in the field of economics, because only through this channel can more cases be analysed on the basis of the same principle so that some relevant conclusions can be drawn. This is especially true for the study of economic reforms in centrally planned economies when the purpose is to generalise the major features of the economic system in transition in various countries. This is because the Soviet-type planning economy is the only one that has been artificially transplanted into other countries from the former Soviet Union. China followed the very essence of the Soviet-type economy in the initial period of its socialist economy (Grossman 1967). This fact makes the ground solid for our relevant comparison. This is despite the historical, societal and cultural differences between the two countries. Furthermore, there are other good reasons for carrying out such a comparative research when it promises fruitful results. First and mainly, the two cases present two different models for the transition of economic systems, in the sense that revolutionary and evolutionary processes took place in each of the two countries with the different emphases in the leading roles of non-economic factors in the process (Goldmans 1987/88). Secondly, these two large planned economies have been the two falling behind on the way to the reform and transformation, compare Hungary, Poland and other East European countries. Their cases thus reveal the data for what

was and is going on in the latest stages of the transformation of the centrally planned economies.

Specifically, the former Soviet Union has also been selected for the present study also because of its special position in the world of centrally planned economies, i.e., it originated them. China is chosen for additional reasons. (a) It rules out the possible argument about the ideal size and level of economic development in a pre-socialist economy for a planning system to work properly and efficiently, an argument often referred to in the case of East European countries (Kaser, 1987). In this respect, China is a better qualified candidate for represent the centrally planned economies than those small but developed countries. So the conclusions from the comparison of the former Soviet Union and China shall be of a more general nature. (b) As one of the world's largest planned economies, China's situation ought to be paid more attention to than before, from Western observers in particular. As a Chinese student in this field, the author feels obliged to introduce a more intimate knowledge of economic reforms in China. So far these have been poorly understood and less well studied than most other planned economies like the former Soviet Union and Eastern Europe.¹ But it is also true that the centrally planned or Soviet-type economy in China has never been an absolute copy of the one in the Soviet Union or other socialist countries (Grossman, 1967). Owing to a complex set of factors, the Chinese economy deviated from the classic original centrally planned economy principally in the following features. Firstly, it is a huge and less well developed country. Central planning control in its regions could not be as tight and strict as in other cases, particularly in the former Soviet Union. Secondly, planning control in China did not cover the economic activity in as detailed and wide a manner as in other planned economies (Goldmans 1987/88). As a result, discretionary and

¹ One can tell this by surveying the relevant publications in the West (in English). However, studies of some centrally planned economies such as North Korea, Vietnam and Cuba are even fewer.

spontaneous behaviour contrary to planning instructions was very possible. These factors made the background to economic transformation in China different from the former Soviet Union.

This thesis does not deal with every detail of all the issues of economic reform in the two countries. Rather, it confines itself to those outstanding points of the major proposals and plans which were adopted or approved officially in China since late 1970s and in the former Soviet Union since the mid-1980s. In certain cases some influential discussions of the major issues in the transition are also included, though they were not accepted for implementation, e.g., some reform plans in the former Soviet Union before and shortly after it collapsed in 1991. Among the reasons for limiting the analysis to official blueprints only are that, although in such centralised societies changes of economic system could happen spontaneously without official approval or advocacy.² They could not be substantial or influential unless approved afterwards by official decree. One can also find suggestions for economic transformation proposed by economists mainly in academic positions. However, only those suggestions accepted by the authorities at the top were likely to be carried out.

Two major questions are examined in the thesis: (1) what are the changes in the existing economic systems that were intended, and (2) how have they been carried out in the two countries? The issues around these questions include the critical aspects of centrally planned economies such as changes in planning control, the status of state-owned industrial entities, and market mechanisms. The process of the transformation in the two countries is also analysed in terms of reform strategies, i.e., the depth, width and speed of the intended changes. Other characteristics of the reform packages in the two countries are also discussed as well.

² For example, there was the case of peasant families dismantling collective labour in agriculture in some provinces like Anhui in China without approval of the central authorities before the end of 1978.

The research has been conducted during one of the most exciting periods in the world's post-war history and in the history of the two countries. This is another reason for their selection. The radical reforms in China and the former Soviet Union have been connected with the names of the two great leaders: Deng Xiaoping and Mikhail Gorbachev. The period from late the 1970s in China is undoubtedly the era of Deng, while the mid-1980s to late 1991 in the Soviet Union is that of Gorbachev. These two men opened the doors to vast new hopes for their countries(Goldmans 1987/88).

An ever increasing number of publications in the two countries, and in the West in English, have been born out of the economic reforms under their leadership. This is especially true in China's case.³ As a major actor on the stage of planned economies, the Soviet Union had always been the topic of a large number of publications in the West. The availability of such material paved the way for the present study. Of course, the author has particular advantage of access to first hand references in China's case. Yet we must be careful approving or disapproving of the sources available to us. The different background, not only economically but also culturally, mean extra efforts must be made to understand accurately the contexts and terms used in the official documents and discussions. Only then can they be correctly understood by outsiders. To take a simple example, the term 'radical' and 'conservative' refer to entirely different things in the West and in China. In China, 'radical' in the discussion of economic reform means advocacy of a market-oriented destination, while 'conservative' means the opposite. In this case, radical reformers in China might be said to be joining the family of the Conservatives in Britain. Furthermore, on some occasions the languages used in official documents is ambiguous on purpose. An intimate inside knowledge enables one to guess

³ The majority of English publications of Chinese economy since 1949 is in relation to the economic reform after 1978.

accurately their real meaning.⁴

We can learn very little from the published works on the comparison between China and the former Soviet Union in relation to the latest movement in economic reform. This is a little researched subject, and and therefore is reason for the selection. Of the few available articles in this field(see Goldmans 1987/88 and Kaser 1987), the discussions are primarily focused on country studies and provide a general cover of political and social factors affecting the course of economic reform. This thesis will thus differ from existing published research in a number of respects. Firstly, the perspective of the present research seeks to generalise the major features of the economic transformation in the CPEs. It is more concerned with theory construction than country studies. Secondly, analytical methods and economic concepts for monitoring the ongoing process of the economic transformation take an important position. This sort of effort, the present author believes, is among the few trial works in the field of comparative economic systems. Thirdly, the thesis covers the most important periods in both China and the former Soviet Union in their economic transition, i.e., the 1990s. There can be no dispute that June 1989 and August 1991 signalled their turning-points. There is no published research work, yet, on the comparative study these crucial periods. Fourthly, as a piece of economics research, the thesis is one of the very few to discuss the economic reforms in the two countries in relative detail rather than just general analysis. Last but not least, the author is equipped with an intimate knowledge of the thinking in the planned economies and the analytical method of mainstream economics in the market economies. It is therefore reasonable to expect some contribution from the thesis to a better understanding of the issues of economic transition in the former planned economies.

⁴ The official document on the regulations for the use of the land leased by peasants in the mid-1980s in China is a good example, since it tried to avoid meaning privatisation but actually implied it (Zhu & Fan 1989).

However, in comparative research there is a particular hurdle that must be crossed. That is the problem of measuring. How can we assess the degree to which things have changed and settled in new positions? One must admit that most issues in this study are hard to quantify, though not entirely unquantifiable. We can reasonably expect some roughly accurate quantification.

(III)

The structure of the thesis is organised as follows. An analytical framework is established in the Chapter Two, which aims at briefly answering the questions that must be discussed before carrying on the research. For example, what is an economic system? What are the differences between a market economy and a planned economy? And more important, how are we to analyse the economic reform? Therefore, the analytical framework discusses the basics of the economic system, the major differences between planned and market economies and the concepts of economic reform. Before the main theme of the thesis begins, Chapter Three introduces the economic and political backgrounds for reforms in China and the former Soviet Union. This examines why a radical reform was unavoidable and possible in the two large planned economies in the period under discussion. It also focuses on the imperative difficulties and problems in the Chinese and Soviet economies up to the late 1970s and mid-1980s, respectively. Then, the root causes for their outstanding troubles are discussed. A brief review of their previous experiences of economic reforms and that of the East European countries is also conducted in this chapter. Finally, political factors in launching the reforms are touched upon briefly.

The main body of the thesis consists of three chapters. The crucial

proposals for economic reform in China from the late 1970s and in the former Soviet Union from the mid-1980s are presented in Chapter Four and Chapter Five respectively. In China's case, the analysis comprises reform plans for sectors and for the entire economy before 1989 and the proposals for further reform after 1989 up until 1992. In the former Soviet Union's case, plans for economic reform in 1987 and the 1990s are dealt with. The Russian reform programme after the disintegration of the USSR at the end of 1991 is also briefly discussed. Based on the data provided in these two chapters, Chapter Six fulfils the task of measuring the reforms in a few dimensions set out in an analytical framework, and of pulling together the general conclusions. The questions to be discussed include the similarities and differences in the major changes proposed in the two countries, the transformation strategies attempted, and concluding comparisons.

Finally, it must be stressed that the result of this study can only be preliminary. It refers to the paper plans for economic transformation in the two countries, though the real situation is taken into account where necessary and possible. Due to the collapse of the former Soviet Union in 1991, many proposals in the country had never been implemented. Whereas the situation in China is entirely different where most of the plans have been carried out. It is therefore virtually impossible to judge which model of transformation is more likely to be successful than the other.

Chapter 2: Analytical Framework: Economic System and Its Reform

Economic reforms and transformations in China and the Soviet Union in this study were recognised in general as the kind of efforts to restructure the economic system, --the centrally planned economy,-- instead of anything else. It is, therefore, very necessary to make reasonably clear the theoretical assumptions about the economic system and its reform. Only on this basis could the proposed subject of research be carried out properly and the satisfactory results be achieved.

Owing to the great contribution of the economists who have been devoted to the discipline of comparative economic systems, it is possible now to set up the analytical framework for this dissertation more or less easily as we can to stand on the shoulders of the predecessors in this field. However, the task of this chapter still remains a hard job, because of the less development of the relevant discipline in regard to our research subject thereby limiting the possibility of constructing a fine infrastructure paving the road for practical research. What was known so far about economic systems, the planned economy in particular, is far from sufficient to explain the practice in a real world, not to say the drastic changes of the existing economies. Therefore, only a rough framework of theory should be expected.

To establish the theoretical framework for our analysis, three aspects are dealt with: a) Basic elements of an economic system; b) Outstanding points of major differences in planned and market economies; c) Some issues of concepts for reforming and transforming an economic system.

2.1 Basic Elements of An Economic System

What are the major components of an economic system? In comparative economic systems, the DIM approach (Neuberger & Duffy, 1976) of economic systems is one of the few plausible arguments at the moment. According to this approach, three structures construct an economic system. They are decision-making structure, information structure and motivation structure. It is by the characteristics of these three main structures that one can tell the nature of an economic system. Or in other words, the differences between various economic systems lie principally in the three structures. However, for the study of economic systems as the present thesis does, the DIM approach is by and large applicable but not fully sufficient. One more key structure must be added, i.e., structure of ownership. The new approach used in this paper is thus the DIMO assumption which is believed more appropriate and sufficient for present research.

2.1.1 Decision-making structure

Of the four basic structures of an economic system, the decision-making structure is considered as the most important and decisive element of an economic system. It discusses the nature, sources and allocation of decision-making authority across the society of an economy. For the purpose of our research, focus is put on the distribution of decision-making power and the means of exercising it in the economy, i.e. the question of who makes what decision and how it is carried out.

The degree of centralisation, or concentration, of decision-making power is the device to measure the pattern of distribution of decision-making power. To name them as two extremes of spectrum, there are at least centralised and decentralised decision-making patterns.¹ Centralised location of decision-making power occurs when there is

¹.In the real world things are certainly far more complex. Any combination of degrees of centralisation and decentralisation could result a number of points on the scale in between the two ends.

only one or few authorities in the society which grasp all major decision-making power, whilst the contrary case is the pattern of decentralised distribution of decision-making power. So, in reality the number and relative importance of the decisions made at the top and higher echelons indicate the extent of concentration of decision-making power.

Apart from the distribution of authority, the means of carrying out any decision also reveal the nature of the decision-making structure. There are at least three alternative ways for a decision maker to implement the decision. Firstly, the decision maker can command other agents to choose specific actions. The second choice is to change the set of alternative actions to provide limited choices for other agents. The third way to achieve the goal of a decision is by affecting the consequences resulting from a specific decision exercised by other agents (Neuberger & Duffy, 1976). From the above list of the means of exercising decisions one can classify the means used in various patterns of distribution of decision-making power. In principle, the first two, defined as direct means, can be taken only under circumstances of centralised control of decision-making authority, and the third one, the indirect one, is the normal channel for a decentralised society where agents can carry out their own decision in that way only.

As a matter of fact, it is extremely difficult, if not impossible, to tell the accurate degree of concentration of the decision-making power in any economy. Of course, the two extremes can not be found in the real world, and there exists only the patterns in between. However, for conventional reasons, the hierarchical structure of decision-making authority in a centrally planned economy is usually categorised as the centralised distribution of decision-making power. It is also commonly accepted that a market economy is of a decentralised decision-making

structure.

Since there are reasons for expecting systemic differences in decision-making behaviours among agents, the pattern of the distribution of the power in the economy plays a crucial role in determining the performance of an economic system. This is the clue to understanding the nature and direction of any economic reforms in a centralised planned economy in particular, and any change in an economic system in general.

2.1.2 Information Structure

Next to decision-making structure, information structure of an economic system takes an important position in the functioning of the system. It performs as the mechanisms and channels for collecting, transmitting, processing, storing, retrieving and analysing economic data for the operation of economic activities (Neuberger & Duffy, 1976). Here the direction and forms of the information flow are of special concern.

Information flows may go vertically or horizontally depending on the requirement of the decision-making system and the nature of the message. Normally a centralised distribution of the decision-making power will need a mainly vertical flow of the information from the higher echelons down to the lower ones as the instructions must be transmitted between them. The means via which the information can be transmitted in an economy can be classified into two main groups: monetary and non-monetary. Monetary means provide information in terms of money, e.g., prices of goods and services(Hayek, 1945). Non-monetary information is involved in the messages in forms of , for example, state order of quantities of products. In this case, money has

no role to play. Moreover, the contents of the information bundle vary in different economic systems with the various direction of the flow, even if to a large extent they are of the same basic nature but different forms. For example, the price of goods in a market economy may be named something else in the planned economy in an instruction or order issued from the top in a planned economy. So the alteration of the forms of information flow also means change, though partially, of the information structure of an economic system.

The role of information structure in the functioning of an economic system also exists in coordination of economic activities which will determine in very large extent the outcome of the economy (Kornai, 1992). That is, the interrelated decision makers act according to the information, obtained through the information mechanism, about those decisions of other decision makers which will affect his set of possible actions, the consequences of his actions and /or the utility he will obtain from any given consequence (Neuberger & Duffy, 1976). The major mechanisms for achieving coordination in the economy are market and planning in the narrow sense of the two terms, apart from their functions as two main categories of economic systems.

The significance of the working state of the information structure shall be emphasised in the sense that when there is no sufficient information provided, problems in the coordination process will occur. There are two possible ways to solve the problems: to adjust the information structure to provide the necessary information; or to change the other parts of the economic system to bring the decision-making power to the agents who have the information (Neuberger & Duffy, 1976). Altering the information structure, approaches can be attempted through the direction and the forms of the information flow. But those changes must be based on the corresponding ones of the decision-making structure, at

least.

2.1.3 Motivation Structure

As far as the third structure of an economic system, the motivation structure, is concerned, the realisation of decisions is discussed. There are various purposes for which the participants in the economy are self-motivated and various ways for them as decision-makers to get other agents to comply with their own wishes. Actually this topic has been referred to partially where the means of implementing decisions are dealt with. Those means are exercised depending on various motivations of the participants in the economy. Generally speaking, the participants can be motivated to carry out any decision because of , 1) reliance on tradition or customary obligation; 2) appeal to egocentrism--accumulation of wealth, respect of peers, etc.; 3) appeal to solidarity or the willing subordination of the individual's personal objectives to those shared by the group; 4) coercion (Neuberger & Duffy, 1976). In other words, incentives of the participants in the economy can be divided into two basic categories: material and non-material ones. Material incentives take, primarily, the form of money, while non-material motivation rely mainly on spiritual rewards.

It is not an easy job to outline the possibilities of adjusting or altering the motivation structure in order to improve the performance of economic activities, because there is a lack of well-designed analytical tools in this respect that can be taken into use here. An understanding of the nature of motivation structure seems to be a much more complicated task than of other structures, notwithstanding the latter task is hard as well. However, changes in motivation structure certainly will result in changes in economic life. Ways of adjusting or altering the motivations prevailing in the existing society normally take place through changing

the predomination of one kind of incentive by the other or diversifying the forms of incentives instead of focusing on one or few of them. For example, some forms of the non-material motivation can be replaced by some of the material incentives as the prevailing motivation in the economy. This process can be realised in some cases by simultaneous consequences of the changes in other structures of the economic system and also through the deliberate plan in changing motivation structure itself.

2.1.4 Ownership Structure

How important is the structure of ownership of productive assets in determining the nature of an economic system, or in influencing the operation of a certain economic system and further the outcome of the economy? It is still a big topic under argument at the moment. Nevertheless, ownership structure of an economy plays an indispensable part from the basic structures of the economic system discussed above (Brus & Laski, 1990). To support this argument, simply pointing out one fact shall be enough. The fact the state-owned enterprises own an overwhelming share in a centrally planned economy, without exception, serves as the precondition for the centralised planning system. Moreover, as commonly recognised, ownership is one of the most important sources for obtaining decision-making power.

Much effort has been devoted to the classification of ownership of productive assets, such as private ownership, public ownership, collective ownership and so on. To the present author, the definitions of the existing categories of ownership are not efficient enough to cover the real situation in practical analysis of this issue. Moreover, they can not explain some type of ownership in practice convincingly. Therefore, in this research, types of ownership of productive assets are

distinguished into two main groups: individual ownership and non-individual ownership. Individual ownership means that physical persons own the property of a business entity, the forms of which may include owner-run private entity, partnership, cooperative, joint-stock company and so on. Non-individual ownership refers to the types of assets owned in the name of , for instance, state, institutions or funds with their legal existence, in which no physical persons are involved as the owners. By this classification of ownerships, the difference between the natures of the two categories of ownership is clearly outlined. But it is still necessary to point out that in some cases the form of organising production can combine the two types of the ownership. A certain form of undertaking can be shared by the two different kinds of ownerships. For example, a joint-stock company can be established by either individual owners, or by institutions, and it can also be owned by the two kinds of owners at the same time. So, the form on its own can not tell the nature of the ownership of the entity² .

The ownership issue here concerns not only who actually owns the assets, but also of the way of operating the business. At this movement, the question becomes more difficult since the methods of managing an entity depend not solely on the status of the ownership of the entity. Many factors play roles on the stage. Based on this point of view, it is reasonable to say that changes on the methods of managing the business without corresponding changes in the nature of ownership can be expected to contribute to improvement of the performance of an economic system.³ The fundamental alteration of the nature of ownership will, of course, play a more important role in this respect.

² In his *The Socialist System*, Kornai discussed in some detail various forms of ownership. (see Kornai, 1992)

³ Commercialisation of State-owned enterprises in reformed planned economy is one of the examples in the sense that attempt was intended to make the enterprises working as an independent producer in market economy without changing ownership of the property. More details will be provided in proceeding chapters.

Up to now, we have covered briefly the four basic structures of an economic system. According to the discussion above, the differences of various economic systems lie, at least, in the differences of the four structures. In addition, any effort to reform or restructure an economic system is equal to changing either some of the structures, or all of them. Of the four basic structures of an economic system, the nature of the decision-making structure has the decisive position in determining the operational characteristics of other structures. In some cases, altering key parts of the structures will consequently lead to the necessary changes of other parts of the structures. For example, if the degree of decision-making concentration is modified towards the decentralisation end of the distribution arrangement, the direction of the information flow will subsequently be, as required, changed from the vertical towards the horizontal so that the new distribution of the decision-making power can work efficiently and properly.

2.2 Major Issues of Differences in Market and Planned Economy

The reason for introducing the topic as shown in the heading to this paper, which focuses on the reforms in two planned economies, is that a broader knowledge of the fundamental differences between a market economy and a planned economy will be absolutely necessary and helpful for a better understanding of the nature and tendency of the reforms in China and the Soviet Union. Because the scope of the reforming efforts in a centrally planned economy should not be limited, both in theory and practice, to a certain boundary by which a market and planned economy is divided. As a matter of fact, there is no clear line of boundary in theory between the two, yet. The author agrees with Prof. Peter Wiles in one of the similarities between a market and planned economy. As he pointed out, “ ‘law of production’ are evidently

everywhere the same" (Wiles, 1977).

Notwithstanding differences between market and planned economies are undoubtedly numerous and are well researched.⁴ What we touch on here is confined to some key points of the following aspects: a) basic features of the structures of economic system; b) major instruments used by governments for regulating the economy.

2.2.1 Market and planning systems: theoretical assumptions

Market and planning systems under this discussion are defined as economic systems instead of any other meaning of them, since the two terms are often used to mean different things in various contexts. Needless to say, there has never been a pure market or planned economy in the real world. However, for analytical simplicity, one must begin with a theoretical model to gain the basis for understanding the real situation.

Analysis of the essence of a market economy is relatively simple. There are various models of market economy, e.g., full market economy, regulated market economy and so on, but the essential difference between them is whether it is profit maximisation or it is profit plus the notional salary of the entrepreneur or even profit plus the whole wage bill that is maximised (Wiles, 1964). Here, a perfect competitive market system can be defined as an economy of complete decentralisation with such a sufficiently large number of decision-making agents in the production of each good and service that none of them is able to have a significant effect on the supply (Neuberger & Duffy, 1976). The market mechanism--the invisible hand--works. In this economy, it is assumed that each agent can consider the actions of other agents as not

⁴ Any textbook in comparative economic systems, or something similar, discusses this issue.

interrelated with his. There exists no central agency exercising any decision-making authority over the economy, and the results on the market place are based solely on the actions of the multitude of buyers and sellers.

The nature of the decision-making structure in a market system determines the features of the information structure. A market economy is served principally by horizontal channels of information transmission through which flow only data on offers of purchase and sale, i.e. only data on quantities and prices. No information is necessarily transmitted on internal conditions within any production or consumption unit, and buyers and sellers do not need to care who send the message. Prices of goods and services are the only signals for decision-making.

As to the motivation structure, pure utility maximisation, e.g, producers maximising profit, sellers of resources equating the utility of income with disutility of providing the service, and consumers maximising the utility from spending their income on various goods, play major parts in motivating the economic activities, apart from other incentives. The invisible hand of the market mechanism, operating through the information structure by changes in price signals and competition among all producers and consumers, mobilises all participants to perform in accordance with the wishes of each other.

The pattern of ownership in a market economy is formed with an overwhelming share of individual ownership under various forms (Kornai, 1992).

like a market economy, there are various models of a planned economy too. In an ideal case, a planned system is doing the same job as the market system does but in an entirely different way (Brown &

Neuberger, 1969). First of all, decision-making power is highly concentrated at the top, the planning authority. Planners seek for the desired state of the economy according to their preferences, and their decisions are supposed to be carried out through the orders to the peripheries of the economy--all the participants except the top agency.

Centralisation of the decision-making structure necessitates the corresponding actions of the information structure. So, obviously, vertical flow of the information is an essential feature there for communication of, 1) all the necessary message from the production, consumption, trade and other economic sectors to the central planning agency, and then, after processing all the data, 2) instructions and orders from the top to the bottom, finally, 3) the feedback information required to evaluate the extent to which the commands are fulfilled. It is apparent that the forms of all the information are not confined only to the quantities and prices, but also others such as qualitative requirement.

The motivation structure of a planned system seems quite complicated, if one accepts the assumption that the objectives and interests of all the participants in the economy are not unified by central planning agency, which is constructed as the foundation of planning control. All the forms of manifestation of the motives can be found out in a planned economy while it is hard to say which of them takes a predominant position. To be coherent with the decision-making structure, the objectives of all participants in the economy must be unified by the authority, i.e, everybody takes the planner's preference as his own preference. The official declaration in this respect makes one believe that non-material incentives are emphasised in this society, but there is no evidence to deny the significant role of the material incentives. Moreover, the variety of the objective functions of other participants in the economy may lead to irrational behaviours of them in providing

inaccurate and incorrect information to the centre, which will cause consequent problems in plan formation, and implementation, if there is no protective measures to reduce or prevent the possibility of this situation from happening. Unfortunately, those problems are monitored in a planned economy as a whole. In one word, structure of motivation of the planning system is distorted and therefore, there is a potential to adjust and improve its operation to serve for better performance of the planning control.

Ownership structure of the planning system looks relatively simple compared to a market system. Non-individual ownership, of it mainly the state-owned business, predominates there. In the ideal situation, the state or its agencies act not only as the owner but also as the manager of its business.

As there is no pure market economy, nor is there a pure planned economy. Some factors of the market mechanism retain in planned economies, such as forms of prices and money. But, as Wiles pointed out, “some of functions of money are cut away by the Soviet-type economy, where inter-enterprise money is ‘passive’, i.e., does not normally affect anyone’s decisions” (Wiles, 1964). The role of money is one of the basic differences between the two economic systems. Monetary relation is essential to a market economy, while in a planned economy money’s role is passive. Monetary relation is weaker and narrower than market economy (Kornai, 1992).

To help summarise the basic features of market and planned economic systems, a simplified panel is given below.

2.2.2 Instruments Focus

Panel 2-2-1 Basic differences in market and planned economy

Structures	Market System	Planning System
Decision-making	Decentralised Indirect means	Centralised Direct means
Information	Horizontal flow Monetary means	Vertical flow Non-monetary & partial monetary means
Motivation	Material-oriented	All
Ownership	Individual	Non-individual

In its broad sense, instruments used by government for controlling and regulating economic activities consist of both qualitative and quantitative tools in achieving the targets set for the objectives. Economic institutions and mechanisms included in the category of an economic system can be labelled as the qualitative instruments. But the instruments studied here are referred to as those major (in very small number) quantitative tools used by governments for implementing its policies. And the analysis focus will be put on some typical and commonly used instruments in a market economy where those instruments are created and developed normally. Quantitative instruments, to a large extent, are not of a neutral nature, except for a few, because they are paid different attentions when serving for different economic systems. Some of them are in affinity only with certain type of economic institutions. The focus on different instruments, therefore, reveals, to some extent, the nature of the economic system, though not as fully as the economic institutions do.

Generally speaking, the following groups of instruments are the

principal ones taken by a government in a market economy (Kirschen, 1974).

Group (1), Public Finance

(1.1) Government expenditure:

Government investment

Current purchases of goods and service

(1.2) Government revenue

Direct taxes on households' incomes

Direct taxes on enterprises' incomes

Indirect taxes on internal transactions and on production

Social security contribution

Taxes on property

Group (2), Money and credit

(2.1) Interest rate instrument

Central bank rate

(2.2) Instruments on credit creation by banks

Reserve ratios, etc.

Quantitative limits on advances

Approval of individual loans

Group (3), Exchange rate

(3.1) Devaluation

(3.2) Revaluation

(3.3) Multiple rates

(3.4) Floating rates

In the planned economy, one can also find out some of the forms of instruments applied in a market economy. But their functions and consequences differ in the two systems. For example, the function of public finance tools in group(1) in a market economy is primarily for improving the income distribution by government revenues and expenditures, which plays a supplementary role. But, in a planned economy income distribution is set at the stage when income is generated. Through public finance tools the state controls the whole economic life.

In a market system money and credit instruments serve for the objectives of full employment, price stability and balance of payments

equilibrium, and also for overall or selective economic expansion. These objectives are pursued in the planned economy by other means, i.e., direct control of the economic activities. As discussed earlier in this chapter, in a typical planned system, tools of money and credit play a very minor and passive role, and sometimes what exist there are only these tools in name.

In affairs relating to foreign economic activities in a classical planned economy, the situation is simple for analysis because of the large isolation of the planned economy from the other part of the economic world, i.e., market economy. In a typical planned economy currency is not convertible to any foreign currency at all, and the exchange rate is officially fixed regardless of any actual change of the circumstances.

After all, in a planned economy, the state is the owner of the major productive means. It is, therefore, fairly reasonable to expect that instruments of direct control play crucial part in this sort of economy.

2.3 Concepts of Reform of An Economic System

The first question that will be raised by a study on economic reform is: what does reform of an economic system refer to? In a conventional definition, reforming an economic system means to change the nature of the basic structures of the system, the mechanisms and instruments related to the operation of the system discussed in the previous two sections. Specifically, to quote Hewett, to reform an economic system is to reform the institutional arrangements constituting the system by which resources are allocated. Every system consists of a set of institutions that somehow decide what will be produced? in what quantities? who will produce it? what techniques and factor combinations will be used? and who will receive the product? Economic

reforms are the efforts to alter the existing way those decisions are made in pursuit of improving the performance of the economy (Hewett, 1988).

The significance of the economic system in determining the outcome of the economy is not a topic of any argument. But it is also true that the outcome of the economy is determined not only by the function of an economic system but a number of factors. Efforts to improve the performance of the economy can be sought in changes to other aspects of the economy instead of the economic system. For instance, slight change of government policy on a specific affair can be expected to produce an effect in terms of improvement.

What is important here is the fact that economic performances could be, without systemic changes, improved by adjusting economic policy decisions. This makes things more complicated because it is very difficult not to confuse the two sorts of reforms in the economy. However, policy changes take place, as commonly agreed, more frequently than those of an economic system. Policy change is the ordinary instrument for government to take in regulating economic activities. On the contrary, effort on restructuring the systemic arrangements and mechanisms takes longer time in debating, planning and implementing. It occurs very occasionally, and in a larger scale than any policy change (Bornstein, 1977). The consequences of the two sorts of changes differ as well in a large degree. The interrelation of the two sorts of changes can be found without doubt, though it can not be expressed in a clear way yet. On some occasions, essential adjustment of important economic policies requires the corresponding actions on a systemic arrangement. Otherwise they will not be realised properly within the existing framework of the systemic structure. Normally the requisite for policy adjustment does not necessarily lead to changing

institutional arrangements, as one can see from the practice. But, the converse is not true. Changes on an economic system will definitely cause large scale changes on economic policies, if not all of them (Bornstein, 1977).

To observe and analyse any economic reform in the CPEs, four aspects must be examined: (a) the degree of the changes intended, i.e., the depth of the alteration; (b) the wide range of the changes; (c) the speed for the action to take place and complete; (d) the relation of the blueprint and the action. Following this way of thinking, four pairs of reform strategies and technologies are to be classified and discussed in this section. These are applicable in the discussion of the main theme of this thesis.

2.3.1 Radical v. Moderate

By radical or moderate we assess the depth of the reform, i.e., the distance away from the classical system, to use Kornai's words (Kornai, 1992). Usually moderate is referred to a kind of adjustment which aims at improving the performance of the existing economic system, while radical means a fundamental transformation of the present system to another type. Specifically, adjustment on an economic system is the kind of reforming effort undergoing within the framework of the existing system. For instance, it may refer to, as often happens, price revision that changes the relative prices of some goods in short supply to meet demand for them while retaining the price formation mechanism intact. If the way of price formation is altered from, say, administrative control pricing to market-clearing pricing, then this sort of effort is thought of as a radical reform instead of an adjustment. At this stage the depth of a reform is of concern.

To state the obvious, economic systems differ in its basic components, and some of the parts play the key roles in determining the nature of an economic system. When the nature of those structures is altered from one end to another, the economic system will be expected to lose its existing essence. A typical case in this respect can be found from the change in the nature of a decision-making structure. When the centralised distribution of decision-making power in a planned system is altered to a decentralised one, accompanied by changes to other parts of the system which take place simultaneously, then the revised system is no longer to be called a planned system⁵. The depth of the change depends on the relevance of the parts being changed in determining the nature of the system⁶. Sometimes a significant quantitative requirement needs to be met as well as such qualitative changes.

It is safe to say that a radical reform creates a new type of economic system which by its nature is distinct from the pre-reformed one. An adjustment of economic institutions will not result in this kind of change.

2.3.2 Comprehensive v. Partial

Under the subheading of comprehensive and partial reform, the scope of the reform will be examined. Proposals for reforming an economic system may be designed for every element of the system, or only parts of the whole system. The former one is called comprehensive reform and the latter partial reform. Let us take an example. A comprehensive reform is conceived when the decision-making structure and structures of information, motivation and ownership of the system are going to be

⁵ According to M. Bornstein, there are two ways of decentralisation, administrative decentralisation and economic decentralisation(Bornstein, 1977). A radical reform, thus, requires economic decentralisation together with administrative decentralisation.

⁶ Kornai made an interesting classification of the causality line of a socialist system and defined accordingly the radicalness of a reform(Kornai, 1992).

touched for altering at mean time. While, if only one of them, or less than four of them will be changed, this sort of reform is of a partial nature.

Judging the type of a reform as comprehensive or partial, one must observe the complete blueprint of the reform proposal and the complete process. A comprehensive reform has to take the form of a partial reform at the beginning by peaceful change suggestions and so on.

Establishing the concepts of comprehensive and partial reforms will be helpful for one to understand the scope of reforms on an economic system and the depth of the reforms, since the two sides of the reform are apparently interrelated.

This raises a question: what is the relation between a comprehensive reform and a radical reform? Or to ask it in other way, how can one label one reform comprehensive and another radical or whatever else composes the pair of terms? In answering this question, it is important to mention briefly the relation between the scope of a reform and its depth. We are enabled to do this, in theory in the first instance, after the above discussion.

On the one hand, first of all, a comprehensive reform does not necessarily refer to a radical reform. It may take place with adjustment of a large number of components in the economic system. At the same time it can be designed as a radical reform with a very high possibility. Secondly, a partial reform can be carried out either as a radical reform or as an adjustment, depending on the objectives it aims at. As a matter of fact, the real situation in this field is not so flexible as the theory defines. Usually, a comprehensive reform is devised as a radical one, and a partial reform as measures of adjustment. On the other hand, a

radical reform usually is formed as a comprehensive one in its scope, though this is not the only possibility of choice for it. Related to this point, a partial reform may bring about with it the adjustment in most cases other than radical reform on the economic system.

2.3.3 Revolutionary v. Evolutionary

Plans on restructuring the economic system could be carried out through a shock treatment at one stroke, or brought in over a longer time period in a gradual way. The speed difference here is classified in this thesis as the revolutionary and evolutionary transitions, though the label of revolutionary is used by other authors for other meaning in analysing economic reforms in the CPEs.⁷ The longer it requires to complete one round of a reform package with the same contents, the more evolutionary and gradual it will be (Dornbusch, 1991). For example, retail price liberation may be planned to finish in one year, or in a few years.

Speed of an intended reform in some cases is determined by the nature of the parts that are to be changed. Some sort of changes of an economic mechanism requires less time or preparation than others. For instance, decentralisation of decision-making power in a certain degree, e.g., between the central authority and local authorities or sectoral authorities seems a relatively easier and quicker task to fulfil than the ones in freeing enterprises or prices.

But, it is also true that the speed of implementing a reform plan in many cases is the choice of the planners irrespective of the contents to

⁷ As pointed correctly by Kornai, there is no consensus in the literature dealing with economic reforms in the CPEs. 'Revolution' is referred to more than one definitions. The word used in this thesis takes the meaning of (a) in his classification (Kornai, 1992), i.e., it refers to a swift, sudden explosion, as opposed to evolution, which is slow and steady process.

be touched. That is to say, there is no definite relation between the speed of a reform and other strategies and technologies. A revolutionary reform could take place as either a radical or moderate, either comprehensive or partial reform.

2.3.4 Theory-led v. Muddle-through

Theory-led in this context does not refer to economic theory that underpins proposals for restructuring the economic system. It is defined as one sort of technology to carry out a reform with which a well-planned blueprint for action is preferred before any reform actually begins. While muddle-through states a situation that less guidance by a working plan is prepared for the changes intended. Spontaneous actions in altering an economic mechanism belong to this sort of technology.

Reformers may choose a muddle-through road for the reform for reasons. For example, preparation of reform plan, including discussion and debating on the critical issues, is time consuming. Due to lack of experiences in designing and implementing economic reform in a planned economy, working out a blueprint appears especially difficult. It is, therefore, not unreasonable to find a reform with less or without well-prepared plan, though theory-led reform sounds a good guarantee for a better result of the reform.

2.3.5 Scale points of transforming an economic system

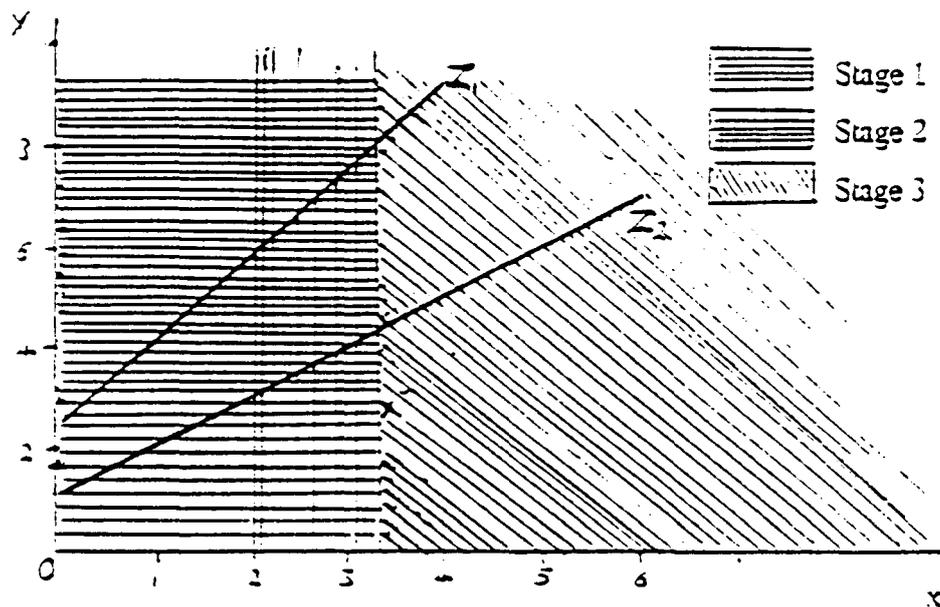
To summarise our discussion about the concepts involved in reforming an economic system, here the present author has attempted to establish a device to indicate accurately the process of the reform.

The degree of the changing process of any basic structure in the system can be expressed as a number of points on a curve on coordinate

depending on the aspects being replaced. In Diagram 2-3-1, the two axes are designed as the depth of change and width of the change. Changes from one end to another, e.g., from centralisation to decentralisation can be dotted by points. Thus, the diagram exemplifies the process as applied to the alternation from a centralised decision-making structure to a decentralised one. There are multiple choices to reach a certain destination depending on various combinations of width and depth of the change intended.

Applying this simple model to explain the transforming process of the complete economic system from one end to another, one can draw a modified graph with more variables. It is needless to stress that this device is taken only for analytical purposes for a better understanding of the nature of the complicated process of an economic reform. There is no intention to explain the reality of economic reform by this kind of tool which apparently neglects some factors.

Diagram 2-3-1 Process of Transformation of Decision-making Structure



Notes: X: depth of the change. Y: width of the change

Z_1, Z_2 : examples of process of transformation.

Chapter 3: CPEs: Radical Reform Unavoidable

Changes in economic mechanisms developed in any country along with the development of their histories. This world is dynamic rather than static. The market economy in the West has experienced a series of changes since its birth. However, the dramatic alterations that occurred in the centrally planned economies in the 1980s made the process distinctive due to the fundamental changes that were introduced there. The basics of the centralised planning system or the administrative control of the economy had been put under a restructuring scheme. It is, therefore, fairly reasonable to raise the question why radical reform of the centrally planned economies was unavoidable in China and the former Soviet Union in particular? And why particularly in 1980s? This is the task of the current chapter. The economic situations in the two countries in pre-reform periods were briefly described in the first section of this chapter. After that, the root causes of the problems and difficulties were analysed according to the individual cases. In the final part of this chapter, the history of reform efforts in CPEs including China, the Soviet Union and the East European countries were generally surveyed in a view of what had been tried to remedy the endemic diseases within the planning system.

3.1 Economic situations in China and the Soviet Union

3.1.1 Imperative difficulties in China

The centrally planned economic system was established in China in early 1950s, following the Soviet model. It was over twenty years later that large scale reform began in the late 1970s. However, in China, it was only in the First Five-Year Plan period(1953-1957) that the Soviet-type system was completely copied after the original one. The centralised

system was more or less modified since, particularly in the location of the decision-making power between the central and local authorities. In the meantime the nature of the administrative control economy remained unchanged until the late 1970s when the new reforms started. The necessity for radical reform arose from the severe difficulties in the economy up to the late 1970s.

Stagnation of living standard and agricultural production

Chinese people couldn't be intoxicated with the records of economic growth on paper when they looked at the figures revealing the situation of their living standard in the late 1970s after nearly thirty years of the communist revolution of 1949¹. The increase of income per capita was almost of a static feature, taking into account the inflation factor. For example, in 1952, per capita income in Chinese currency--RMB yuan--was 104 yuan. In 1966, the beginning year of the 'Cultural Revolution', the figure was over 200 yuan. Then, ten years later, in 1976 the amount only increased to 261 yuan. To be more specific, employees in the state-owned sector got their average wages increased by only 1.1 percent annually in current price since 1957 (Riskin, 1987). This meant that every year the average wage rose only 0.33 yuan, which was very likely to be offset by very moderate inflation². According to some estimates, the average wage in real terms in 1977 was 17 percent lower than it was in 1957 (Riskin, 1987).

Not only the income, with a rate of 2.2 percent of consumption growth annually from 1953 to 1978 (Riskin, 1987), people found the increase of volume of food and other consumers' goods very slow as well. On

¹ Economic growth rates till 1970s in China, according to its official figures, were retained at a quite high speed. they were especially outstanding compared with other relevant countries. (See Zhang, 1982.)

² Here are examples of the figures of inflation in China in the period before 1980s: the Retail Price Index in 1957 was 1.5%, and in 1978, 0.7%(State Bureau of Statistics, 1990).

some occasions, they even suffered a reduction of food supply. Table 3-1-1 provides the relevant figures.

Table 3-1-1 Increase of consumption of major agrarian products per capita, 1978 compared to 1957

Grain	Cotton	Edible Oil	Meat	Seafood
4.6%	- 13.5%	- 17.4%	43.2%	- 1%

Sources: Chen Xiwen, "China's Agricultural Economy: from over-fast growth to normal growth", in *Economic Research*, No. 12, Dec., 1987, p.23.

Apart from this, the housing problem appeared serious too, due to the neglect of 'non-productive' sectors over a long period. The already cramped housing space of 4.3 square metres per urban inhabitant in 1952 declined to 3.6 square metres in 1977 (Riskin, 1987).

The stagnation and deterioration in people's living standards throughout the whole country was severe. Meanwhile the situation in the rural areas was even worse. With about 80 percent of the population staying in rural areas, agriculture in China played a significant role in national economy. It must, first of all, supply food and other basics for the whole population which had already reached one billion by 1978. According to Chinese estimates, besides food, still 80-85 percent of the necessities of the population had to be met from agricultural production in the 1970s. Furthermore, at the present stage of economic development, agriculture was a very important source for capital accumulation for industrialisation. By the exchange of industrial goods and agricultural products at unfavourable trading terms for the latter, agriculture had provided a huge amount of capital to non-agricultural sectors. For example, 60-90 percent of foreign currency required by industry was gained through export of agricultural products during the 1960s and the

1970s(The State Committee for Reform of the Economic System, 1988b).

However, the growth of agricultural production was far from satisfactory. The annual growth rates of gross output in this sector was 4.2 percent in the period of 1952-1978 (see table 3-1-1). In the same period, grain increased 2.4 percent, cotton 2.0 percent and oil-bearing seeds 0.8 percent annually (The State Committee for Restructuring Economic System, 1988). During this period, the population grew at the rate of about 2 percent annually(State Bureau of Statistics, 1990).

The productivity of labour in agricultural production had not been improved at all. Up to 1980, the grain output per agricultural labour still remained at the level about 1,000 kg, which was the 1957 figure , despite investment on infrastructure and technology (Chen Xiwen, 1987).

The state of poverty in rural area in China at that time after thirty years of 'socialism' was shocking. It was admitted that there were about 100 million amongst the rural population still suffering from starvation up to the late 1970s (The State Committee of Restructuring Economic System, 1988).

Disproportion of the economy

The imbalance of economic structures was one of the outstanding problems in the Chinese economy in the late 1970s. It expressed itself mainly in two ways. One appeared as the disproportion in the growth of various sectors in the economy. The other was represented in an irrational ratio of the distribution of national income between accumulation (investment) and consumption.

For a long period the actual order of priority for sectors' growth was

the typical pattern of the CPEs as follows: heavy industry first, light industry second and agriculture last. The order was believed necessary for fast growth of the economy by the planners(Liu, 1984). As a result, the irrational structure of the sectors developed. Table 3-1-2 showed the picture below.

Table 3-1-2 Economic Structures in 1966 and 1976 in China

	<u>GSP (100%)</u>		<u>NI (100%)</u>	
	1966	1976	1966	1976
Agriculture	29.7	25.4	43.6	41.0
Industry	53.1	58.1	38.2	43.3
Construction	6.4	8.0	3.7	4.9
Transportation	3.3	2.9	4.2	3.8
Trade	7.5	5.6	10.3	7.0

Sources: Li Chengrui, "Analysis of China's economic situation during the decade Of 1966-1976", in *Economic Research*, No. 1, 1984, P28.

Notes: GSP--Gross Social Product

NI--National Income

It was clear that the relative position of agriculture in national economy was weakened in the late 1970s because of the relative decline of its growth. Within the industrial sector, the share of light industry increased, but not as fast as heavy industry. In addition, the latter itself was faced with the problem of the underdeveloped mining branch and overdeveloped processing branch. As to other sectors, the decline of transportation and commerce was obviously against the rational pattern of economic development, and inevitably aggravated the bottleneck of infrastructures in the economy.

The inappropriate ratio between accumulation and consumption was the

other sort of disproportion. This problem seemed to be of a longstanding nature too. In 1952, the share of accumulation took 21.4 percent of the total national income. In 1966 it increased to 30.6 percent and afterwards it remained at this level, while it sometimes went up to 34.1 percent in some years during the decade (Li Chenrui, 1984). Apart from the large share of accumulation, the distribution of the investment was not for 'non-productive' sectors, such as housing, hospital, school and so on. This was because, during the First Five-Year Plan period (1953-1957) 67 percent of total investment was devoted to productive sectors and 33 percent to 'non-productive' sectors. In the late 1970s the ratio became 82.8 percent : 17.2 percent (Li Chenrui, 1984). This policy of investment left consumption unimproved over a long time, and intensified the trend towards an unbalanced development of the economy.

Productivity

In contrast to the sustained high rates of economic growth, the productivity growth in the Chinese economy was not optimistic at all. It was not unfair to say that Chinese economic growth had been gained, to a very large extent, through a huge increase of resources rather than their efficient use. In general, from 1953 to 1980, the gross value of fixed assets in state-owned enterprises grew twenty times, and the gross value of circulating capital eighteen times. But, the increase of gross social products was only 7.2 times, and national income 4.2 times(Li Chenrui, 1984). If we took the output per unit of capital in industry in 1952 as 100, then, in 1957 it was 103. In 1965 and in 1978 they were 68 and 74 respectively (Riskin, 1987). So, the state of capital productivity in the late 1970s was unsatisfactory indeed as compared to any of the previous period. Things were not so bad in the increase of labour productivity since in State-owned enterprises it went up. This achievement was mainly realised through increase of amount of capital per worker.

Unemployment

The word “unemployed” was pronounced only in the late 1970s in China. After the communist revolution, the government had claimed that it eliminated any kind of unemployment and every person was guaranteed a job. This was more or less true at least in urban areas up to the 1970s. But, with the ending of the ten years ‘Cultural Revolution’ when a huge number of young educated people returned from the countryside to their own cities and towns where they used to stay,³ the work of allocating them a job, as well as others of working age at that time, was far beyond the capacity of the planners’ control. A new and urgent problem occurred.

According to available estimates, in 1979, the number of the unemployed population in urban area amounted to approximately 10 million, or 9.5 percent of the total non-agricultural labour force. In 1980, the figure turned to be 12-13 million (Riskin, 1987). Due to the poor statistics in this field, exact figures of rate of unemployment in the late 1970s were not available, but 5 percent was a reasonable estimate. In Liaoning Province (in North-East of China), for example, in the years from 1977 to 1980, there were about 2.6 million people waiting for jobs, among them 2 million were educated young people coming back from the countryside (Li Chengrui, 1984).

The impact of the unemployment problem was felt not only in its own economic sense but also in its social consequences. The society was in danger of upheaval with the sudden growth of an idle population and increasing resentment towards past and present policies on their fates among the young educated people and their families.

3.1.2 The outstanding problems in the Soviet economy

³ It was a policy during late 1960s--late 1970s that a majority of school graduates in urban areas must go to countryside to be peasants.

Economic growth

Economic growth had been the most important indicator in the Soviet economy, and high growth rates had been the top goal of planners. But the trend shown in Table 3-1-3 was not optimistic. Due to the well-known unreliability of Soviet statistics, a supplementary picture was provided in Figure 3-1-1.

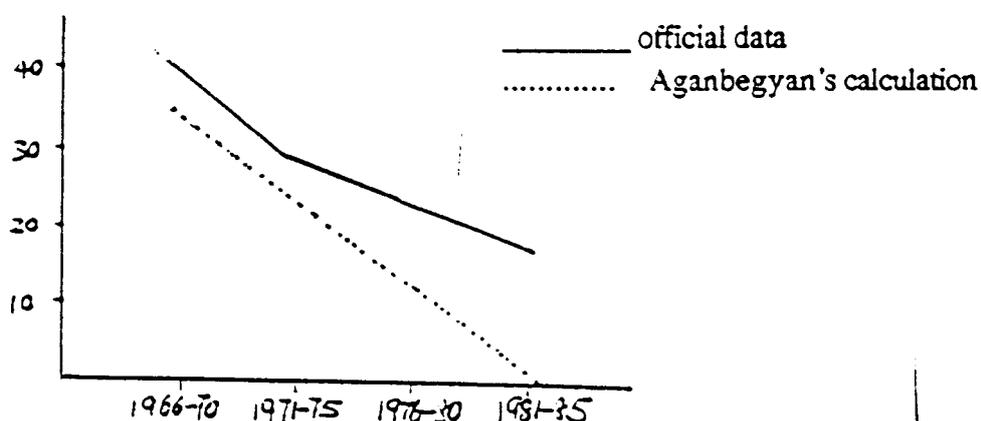
Table 3-1-3 Soviet Economic Growth Rates (%), 1951-1985
(Average Annual Growth Rates, comparable prices)

	1951-55	1956-60	1961-65	1966-70	1971-75	1976-80	1981-85
Official Data							
NMP	11.3	9.2	6.5	7.8	5.7	4.3	3.6
NNP	9.5	8.2	6.0	7.1	5.1	3.8	3.2
Western Data							
GNP	5.5	5.9	5.1	5.2	3.8	2.7	2.4

Sources: Zbigniew M. Fallenbuchl, "Soviet Economic Reform", in *Canadian Slavonic Papers*, No. 3, 1988, p. 306.

Notes: NMP--Net Material Product produced
NNP--Net National Product utilised

Figure 3-1-1 Growth rates of national income in USSR, 1966-1985



Sources: Abel Aganbegyan, *The challenge: Economics of Perestroika*, Hutchison Education, 1988. p..2

It was clear that in the mid-1980s the growth rates in the Soviet economy could never reach to the height gained in mid-1960s, not to say the peak of the post-war period. And the decline of growth rate up to the mid-1980s lasted for an ever longer period which enabled us to take it as the most serious drop of growth rates till the mid-1980s in Soviet history. This conclusion might need a slight revision when one studied the growth record year by year instead of in five-year intervals. The growth curve showed a small upward movement in one or two years in a declining five-year period. However the general tendency in Soviet economic growth rates after the 1970s was one of a downward curve.

The declines of growth rates occurred not only in the aggregate economy, but also in sectors. In industry, from the late 1970s to the mid-1980s, things were even worse than the overall growth rates (Gregory & Struad, 1986). The worst case in growth rates was found in agriculture (Nove, 1986b). The Soviet economy had been perplexed by its weakest sector almost since the new economic regime was established. In post-war periods, the growth rates in this sector fluctuated sharply. Agriculture was in a position of permanent crisis (Aganbegyan, 1988). But it seemed that Soviet economy was used to surviving with its poor agricultural production owing to its capability of importing grain by selling its oil and other natural resources. So, the difficulties there might not be considered as severe as those in industry and the overall economic growth.

Growth of productivity

With economic growth rates going downwards, the performance of productivity was even worse, especially of the slow and stagnatory capital productivity growth. Over two and half decades since the 1960s capital productivity remained a negative growth pattern. The situation in all factor productivity and labour productivity and in industry were

described by Table 3-1-4.

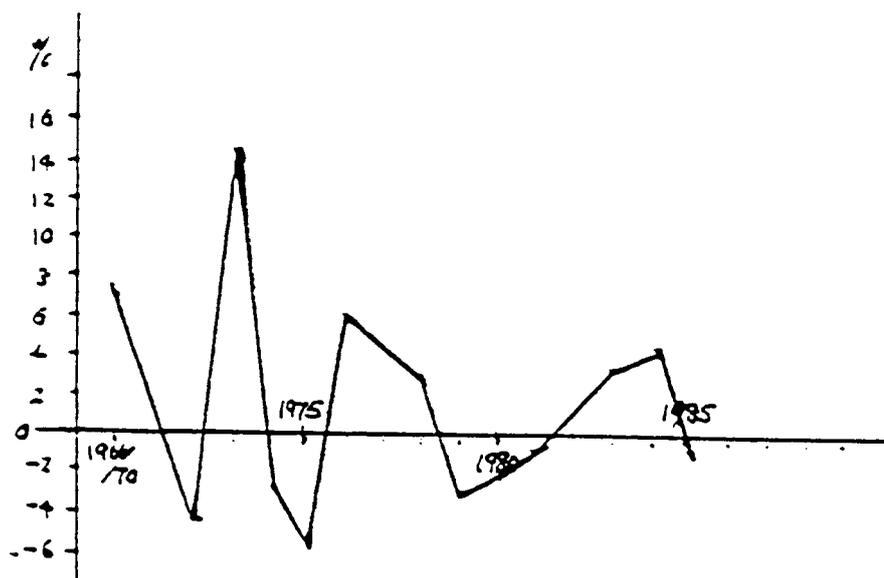
Table 3-1-4 Factor Productivity Growth Rates in the Soviet Union, 1961-1982
(Average Annual Growth Rates)

	1961-65	1966-70	1971-75	1976	1977	1978	1979	1980	1981	1982
Overall factor productivity	0.5	1.1	-0.05	1.0	-0.1	-0.3	-2.6	-1.1	-1.6	-1.3
In industry	0.1	0.6	1.0	-0.9	-0.3	-2.6	-2.2	-1.1	-1.6	-1.3
Labour productivity	3.4	3.2	2.0	3.5	2.1	1.7	-0.8	0.6	1.2	0.9
In industry	3.5	3.1	4.4	1.8	2.6	1.6	0.7	1.7	1.6	1.5

Sources: Paul R. Gregory & C. Stuart, *Soviet Economic Structure and Performance*, third edition, Harper & Row Publishers, New York, 1986, p. 335.

As far as the increase in agricultural productivity was concerned, the rates of growth in output per agricultural labour might give an answer. (see Figure 3-1-2).

Figure 3-1-2 Rates of growth of output per agricultural worker



Sources: David A. Dyker, ed. *The Soviet Union under Gorbachev: prospects for reform*, CROOM HELM, 1987, p.96.

Having examined the records of growth in productivity by the relevant indicators, it seemed safe to conclude that the Soviet economy had been facing a very serious challenge in the sense that it could not sustain a reasonable efficiency in the use of its existing economic resources.

Consumption and “quality problem”

It is necessary here to distinguish the types of consumption in a Soviet-type economy: the collective consumption which may be taken as a sort of population welfare, and the private consumption. Because in a socialist economy, the collective consumption, such as medical care, child care and so on, took an important position in population’s wellbeing. Consumption was the sector in the Soviet economy which was treated as the last one on the planners’ priorities lists. First of all, the increase of disposable income showed a slow and declining trend. What was more significant was the fact that with the permanent shortage of consumers’ goods, which was described as one of the essential features in a centrally planned economy by Janos Kornai (Kornai, 1980), the slow growth in income could not be turned into real consumption. To some extent, for the Soviet people paper currency was an empty promise.

In social welfare, the field of collective consumption, past achievement seemed to stop growing. Under the circumstances of slow economic growth, it was hard to resolve the problems occurring in relation to social welfare of the Soviet population. As Aganbegyan admitted, the fall in economic growth rates had been especially painfully reflected in this sector. Because resources were allocated to social welfare according to the so-called “residual principle”, housing, health care and other items were always the last customers on the queue to be served depending on how much investment had left after allocation to productive sectors. For example, the share of investment allocated to housing construction was reduced from 23 percent in 1960 to 14-15 percent in 1981-85 period.

The expenditure on education once amounted to 10 percent of national income in 1950 (the highest rate in the world at that time), but in recent years it fell to 7 percent. The situation in health care was also unsatisfactory. Only a mere 3 percent of GNP was devoted to this sector, which was the smallest share compared to all developed countries. The infant mortality in the Soviet union in 1985 was 26 out of 1,000 and was the fiftieth place from the top in the world. Life expectancy at birth was 63 years for Soviet men in 1984-85, which put the Soviet Union on the same line as the upper middle-income countries, such as Mexico or Brazil (Aganbegyan, 1988).

Secondly, the poor quality of goods and services aggravated the situation. The quality problem was not confined to consumers' goods and services, though consumers suffered from it directly and in some cases to an intolerable extent. Soviet defence factories could provide some products competitive with the best available in the world. But most civilian goods were "terrible"--quoting Abel Aganbegyan's word-- in terms of quality. According to an estimate, only 17-18 percent (by the most optimistic estimates) or 7-8 percent (by the most pessimistic estimates) of Soviet manufactured goods reached "world standards" (Aganbegyan, 1988). In other words, only these could be sold in world markets. Even in its trade with Eastern Europe, the Soviets could not compete in manufactured goods. Its export structure of goods was typically that of a developing country. According to the UN Economic Commission for Europe, in 1955, 28 percent of Soviet exports to Western Europe were manufactured goods, in 1983, the figure fell to 6% (Aganbegyan, 1988).

In the domestic market, even if there had been excessive demand on the market the stocks of some goods were piled up because consumers refused to accept them. Aganbegyan had made an eloquent assessment

about the deteriorating tendency of goods quality (Aganbegyan, 1988):

From year to year we lose our former advantage and positions. Remember the fifties. Yes, our things were not as beautiful and fashionable as foreign ones, but as a compensation any of ours were hardwearing...And how is it now? It is a horrible situation: more than two thousand times a year colour television sets catch fire in Moscow alone. Together with the houses burn.

Defence sector

The defence sector was the place where the Soviet Union showed its great strength. And there had been an argument for a long time which assumed that a Soviet-type economy ideally met the requirement of rapid military expansion at the expense of civilian production and consumption. In fact it had been generally agreed that the Soviet Union had been able, up to the mid-1980s, to compete with the U.S. defence establishment while the productive capacity and living standard there fell far behind the U.S. However, along with the chronic slowing growth of the economy, and with the changing character of military technology, the former top priority sector found itself in an embarrassing situation. Firstly, increasing attention had to be put on the opportunity costs of military priorities when the economy could not retain a reasonable rapid growth rate since the 1970s. According to CIA estimates, from the mid-1970s on, the growth rates of Soviet military spending had fallen. During 1966-1976, the rate was 3 percent annually in constant US Dollars and 4-5 percent annually in constant Rubles; from the mid-1970s on, the rate was down to about 2 percent per annum, either measured in constant Dollars or in constant Rubles (Bova, 1988). This was obviously a result of the high pressures from the overall slowdown of economic growth. In turn the cut-down on military expenditures would be significant in the sense that the U.S.S.R.'s military power compared to the U.S. had, though not only, been based greatly on its quantitative advantages.

At the meantime, Soviet defence power was faced a new threat coming from the changing role of military technology which had made much recent progress. In most, the Soviet Union was left behind the U.S., e.g. microelectronics, computers and software and biotechnology etc. (Bova, 1988).

3.1.3 Problem patterns in the Chinese and Soviet economies

On the basis of the data provided in the previous sections, a comparison of the major economic problems in China and the Soviet Union is now possible. The result of the comparison revealed an interesting pattern in the two countries. The number one difficulty in the Soviet economy was the sharp decline of economic growth rates, whereas the comparable problem in the Chinese economy was found in stagnation and deterioration of people's living standard, which was the other side of the growth problem. In the Soviet Union increase in living standard in terms of growth of per capita income did not become the very outstanding problem, although people found some difficulties in realising their income due to the short supply of consumers' goods and services.

Agriculture was the place which had a similar rank in the problem list in the two countries. The growth of agricultural production and productivity in both of the two economies was far from satisfactory. But it seemed that the consequences of the underdevelopment of agriculture were not exactly the same as it ranked on the list, because the Chinese economy suffered much more. As explained in this Chapter earlier, the Soviet Union could afford to import its grain and other agricultural products to solve and ease its problem of agricultural production. China could not follow in this way as there was no sufficient exporting capability from the natural resources.

Other problems with a similar rank on the list were the disproportion of economic structures and the slow or negative growth of productivity in the two economies.

It seemed safe to conclude that there were two problems in the two economies that could not match their counterparts in each other economy. They were the difficulty in employment in China and the growth of the defence sector in the Soviet Union. This result required to be explained in the perspective of special circumstances other than the economic system in the two countries. It was to be dealt with briefly in Section 3.2.1.

In short, the first three or four serious problems in China's economy were the stagnation of living standard growth, agriculture, disproportion and productivity growth. In the Soviet economy they included decline in economic growth rates, productivity growth, agriculture and disproportion. Of those problems we found three from each economy match each other in a broad sense. They shall become, logically, the starting point for exploring the root causes, because these similarities occurred out of the very few similarities in the two economies. i.e. the centrally planned system. We hypothesized, at this stage of the present study, that the main difficulties in the two economies were endemic in the centrally planned system. To prove this hypothesis is the task of next section.

3.2 Challenges for the CPEs

What challenges were the centrally planned economy facing in China and the Soviet Union? Why was radical reform necessary? The study on the major problems and their sources in the two economies enabled us to draw some principal conclusions.

For any problem in an economy, the causes could come from various sources, such as political, social, cultural and economic etc. In our discussion of economic reforms in China and the Soviet Union, what is concerned here are the problems endemic in the centrally planned economy. Those problems and difficulties occurred in the two economies could be in principle attributed to two groups of sources: the systemic ones and non-systemic ones. By this classification, those problems caused mainly by non-systemic factors should appear in the face of new troubles which might be explained by casual and special events in each of the country. In this section, we were, at first, to undertake a brief study on some special newly occurred problems in the two economies in order to clear up the way for our further relevant discussions. Then, the tough job to dig out the roots of major problems in our two cases were carried out.

3.2.1 Explanations for some special problems

External sources of China's troubles

As I pointed out earlier, Chinese economy up until the late 1970s worked adequately in terms of the economic growth speed. But this had not saved it from trouble resulting from other severe problems in the economy. Why did those difficulties occur, or were they aggravated, in the late 1970s? Were there special events that might cause these results? Reviewing China's economic history since late 1940s, one could pick up at least two factors that negatively aggravated economic situation in the late 1970s.

The first one was found in the over-fast growth of population. China was an over-populated country in the world even in 1949 when the total population was already more than half a billion. However, according to

Mao Zedong and his allies, a large population was an advantage for the country. It was believed that the more people, the more powerful the communist country. Thus any idea of population control was criticised and forbidden. And no measure had been taken along this line until the mid-1970s. As a result, the growth rate of population retained at over 2 percent annually, and sometimes it went up to 3 percent every year. Therefore, it was not surprising that in 1966 China's population went up to 0.745 billion, and in 1978 the figure rose to about one billion. Within less than 30 years the population doubled on the basis of half a billion (State Bureau of Statistics, 1990).

The huge burden of population on the economy seemed too heavy to be borne by the country where the level of economic development was still very low, despite high growth rates. The over-fast increase of the population made the heroic records of overall economic growth inferior when measured in terms of per capita. The stagnation and decline on living standard was partly the result.

Moreover, the difficulty in employment in the late 1970s, to a large extent, should be attributed to the consequences of over-fast growth of population, too. It was true that the sudden increase of unemployed population in the late 1970s was primarily caused directly by the rapid return of the young educated people from the countryside. However, this movement was nothing more than the exposure of a longstanding problem. Why were hundreds of thousands of the urban educated young graduates sent to countryside during the 'Cultural Revolution'? Besides the political consideration⁴, to reduce the pressure of employment in cities was also a key concern. Since the industries could accept only a small share of the school graduates every year, the majority of them

⁴ Mao Zedong believed that workers and peasants are more revolutionary than the intellectuals. Therefore, he thought it necessary for the young educated people to be re-educated in the countryside by working together with the peasants.

could either become peasants, or stay in the cities as unemployed. But the latter choice was not allowed officially. So the problem was disguised by reducing urban population and postponing it for a few years later.

Another important factor in explaining the severity of economic and social problems was the influence of ten years of 'Cultural Revolution'. It was inaccurate to say that those imperative problems in the Chinese economy and society were caused directly by the 'Cultural Revolution'. But the political movement must be blamed for worsening the situation.

In the first instance, the large scale mass movement destroyed the necessary order for efficient and proper working of the economic mechanisms. For instance, in the early years of the "revolution", the economy ceased growing but declined, because production was often stopped or interrupted in order to allow people to participate in political meetings and demonstrations. The consequence of political pounding on an administrative economy certainly must be serious.

The more harm the ten years' revolution did on the economy lay also in its encouraging, by political need, the traditional strategy of economic development which distorted the rational structures of the economy and led the economy into a vicious circle. Needless to say, unemployment was partly the result of the revolution, too.

Exogenous factors of Soviet problems

When people, both Soviet economists and Western observers, tried to discover the factors undermining economic growth in the Soviet Union, the immediate and definite candidate was the shortage of newly supplied natural resources inputs starting from the late 1970s. In the past, Soviet economic growth realised itself relying, to a considerable extent, on

significant increase of natural resources, materials, and labour etc. Taking a typical postwar five-year period as an example, e.g. 1970-75, in these five years, the extraction of fuel and raw materials grew by 25-30 percent, and a further 10-11 million people were recruited. However, this scale of increase of resources supply ceased after the mid-1970s due to natural or historical reasons. For example, growth rates of production of fuels and raw materials declined sharply, from 25 percent in 1971-75 to 10 percent in 1976-80 and 7 percent in 1981-85. The same pattern appeared in supply of labour force. In 1971-75 growth rate of employment in production sphere was 6 percent, in 1976-80, 4 percent and in 1981-85, 2% percent(Aganbegyan, 1988).

The decline in growth of extraction of fuels and raw materials was mainly connected with the worsening geological and economic conditions in mining. The most accessible natural resources were not in sufficient supply to meet the requirements of demand, and in many of these kind of regions the volume of extraction slid down. So, it was necessary to dig for deposits in Siberia and to discover new deposits in the Northern and Eastern regions where the cost of production was unavoidably rising (Joint Committee of Congress, 1982).

The reason for reduction on labour supply growth seemed simple. As a matter of fact, from 1981-85, the Soviet Union entered a demographic slump which directly reflected the consequences of World War Two. The number of children born during the war, and the next generation of those children who were just at working age in the late 1970s, was smaller than any other generation (Aganbegyan, 1988).

Of course, shortage of resources supply, either in fuel and raw materials or in labour force, could not be completely separated from the factors of economic system in terms of its efficient use in production. The deeper

roots of the problems were to be discussed later.

The military burden on the Soviet economy seemed to be another non-systemic factor in affecting economic growth. The defence sector was the one that benefited most from the Soviet-type economy. But it could contribute very little to the civilian economy. It became more and more a burden, and played some part in the slow economic growth rates. Even the lowest estimates showed that a large share of resources was devoted to military purposes⁵. This would undoubtedly weaken the capability for economic growth and improving or solving the longstanding problems in the economy. Retaining a relatively stronger defence sector seemed to have no direct relation with the centrally planned economy.

Apart from the factors mentioned above for the Soviet economic difficulties, there was one more factor that should not be neglected. The Soviet Union had to take care of its CMEA countries by supplying cheap raw materials and other economic aids. This could have aggravated its own difficulties, too.

To conclude, the sources of the outstanding problems in China's economy in the late 1970s, one should say that some external or non-systemic factors played an important part in explaining some difficulties, such as unemployment and the stagnation and deterioration of people's living standard. Nevertheless, the major problems in China's economy in the period under discussion had something to do with the centrally planned economy instead of casual factors. Exogenous sources might aggravate the situation, but they could not on their own cause those serious problems in the economy. Even the so-called exogenous factors

⁵ There was no exact figure of how much of GNP that was spent on military expenditures. A 25% estimate was thought reasonable by Prof. A.Nove when the author discussed this issue with him.

themselves might be created in the land of the centrally planned economy. At least the centrally planned economy provided the stage for those actors.

The Soviet case seemed convincingly to prove the argument that the majority of the imperative problems in the Soviet economy had been caused by the economic system, as one could not find out more than few causes to blame without referring to the planning system.

3.2.2 Root causes of the major problems

Economic growth rates

Economic growth rates had been the most important goal of planners in centrally planned economy. It was in this field that the heroic records had been made in both China's and Soviet economy. As a result, it had been suggested that the centrally planned economy was superior in promoting a rapid economic growth to the potential limit, which made the market economy too inferior to bear a comparison (Hewett, 1988). Many factors which contributed to rapid growth rates in a Soviet-type economy could not be found in a West market economy. For example, the government was more continuously interested in the tiniest details of economic efficiency than any other government. Given an equal volume of investment in a Soviet-type economy and a West market economy country, much more funds were directed towards uses that promoted further economic growth in the former case (Wiles, 1964). The achievements in this respect by the Soviet Union up to the mid-1960s and by China up to the late 1970s proved the assumption. However, the empirical studies on economic growth rates in later periods in the Soviet Union, i.e. after the mid-1960s, cast doubt on the full conviction of the assumption. The comparison between the Chinese and Soviet cases supported the doubt. A revision on the assumption was necessary,

because it was only true conditionally. That is, the miracle of rapid growth rates performed by the centrally planned economy could be sustained only in a certain period and by extensive means (Goldman 1983). To be exact, it was only in the early stages when the planned economy started to work could it mobilise all the potential possibilities to reach ever high growth rates of the economy at any cost. As it was correctly pointed out, “ a nation’s reserves have all been mobilized “(Wiles, 1977). In addition, the possible miracle also depended on the conditions of endowment of economic resources in the country under which the centralised planning system could play its full part. The difficulty faced by the Soviet economy in the mid-1980s in getting sufficient supply of resources, e.g. raw materials, fuel and labour, contributed to a large extent to the severe situation of economic growth. The planned economy failed in sustaining a reasonably high rate of growth because it failed to expand the economy in an intensive way (Schroeder, 1986).

Agriculture

The experiences in agricultural production in the Chinese and Soviet economies made it crystal clear that this sector had got no benefit from the centralised planning system, either in the early stages or in late periods. In turn, both China’s and Soviet economy was troubled greatly by the underdevelopment of agriculture. The situation in China was more severe because the starting level of agricultural production for further development technically had been low under the circumstances of its huge population. This conclusion made it convincing to argue that the centrally planned economy failed to promote reasonable development in agriculture which made that sector underdeveloped compared with other sectors in the economy (Nove, 1986a).

It seemed that the advantages of the centralised planning system could not

be taken properly in organising agricultural production as it was in non-agricultural sectors in the two economies. The following are the main reasons. First of all, as far as the natural conditions for agricultural production were concerned, they did not provide much possibility for a central planning system to achieve what it could in other fields of the economy, for example, the rapid growth rates in industry. Because there were fewer unused resources which could be mobilised to realise an extra high rate of growth in agricultural production. China was rich in labour force but the cultivable land was in short supply. In the Soviet Union, the contrary was the case: surplus cultivable land but shortage of labour since more and more peasants left for the cities. Therefore, agriculture by its nature was not the ideal stage for the centrally planned economy to play its full role. Moreover, this type of economic system only made things worse in agricultural production (Wiles, 1977). The way in which the agricultural production was organised in China and the Soviet Union was principally the same: collectivisation and centralised management. The outcome seemed against what had been expected by the planners who firmly believed that collective farm and planned direction would bring about a faster growth in agriculture than ever before. Unfortunately, the results did not verify the assumption. From our two cases, it seemed that agriculture was not the proper place to implement central planning management due to the characteristics of production which were quite different from industry. To direct production of every village, commune or collective farm under various working conditions correctly and promptly was beyond the planners' capability in both our cases. Sometimes such strict control resulted in damage and made things even worse. This was described by Nove as the poor planability of the central planning system (Nove 1986c).

The failure of the planning system in agriculture was attributable not only to technical reasons but also to the relation between peasant and the

non-individual ownership of production means. The collectivisation in agriculture had been done mainly by compulsory or violent ways in the two countries, although the process was not exactly the same in each. Peasants showed little enthusiasm on working in the public field.

Agriculture was supposed to play a very significant role in national economic development as a source for primitive capital accumulation for industrialisation in a centrally planned economy, where some other sources like foreign investment was in short supply or unavailable. So, it was not surprising that planners always attempted to get more and more surplus from agriculture by every possible means, such as unfair scissors prices in exchange of agricultural products and manufactured goods, over-high rates of taxation etc. Collectivisation and planned control of agricultural production served this purpose too. In the Soviet Union planners went further in this direction, especially in its early stages of industrialisation, than in China. Such a status for agriculture in a planned economy determined the attitudes of the planners towards this sector. No priority was given to it, unless it was exploited too much to retain a survival growth. However, due to the problem of planability in agriculture, the situation could not be much improved even when it was given the policy priority for investment after Stalin's time.⁶

All those factors above, together with mismanagement in this sector, left little room for agriculture to develop itself normally, if at all.

Productivity

Economic efficiency was one of the most important concepts which must be discussed in the analysis of any economic system. Because it was not easy, if not impossible, to formulate an accurate quantitative measure to evaluate the efficiency of production, productivity turned to be an

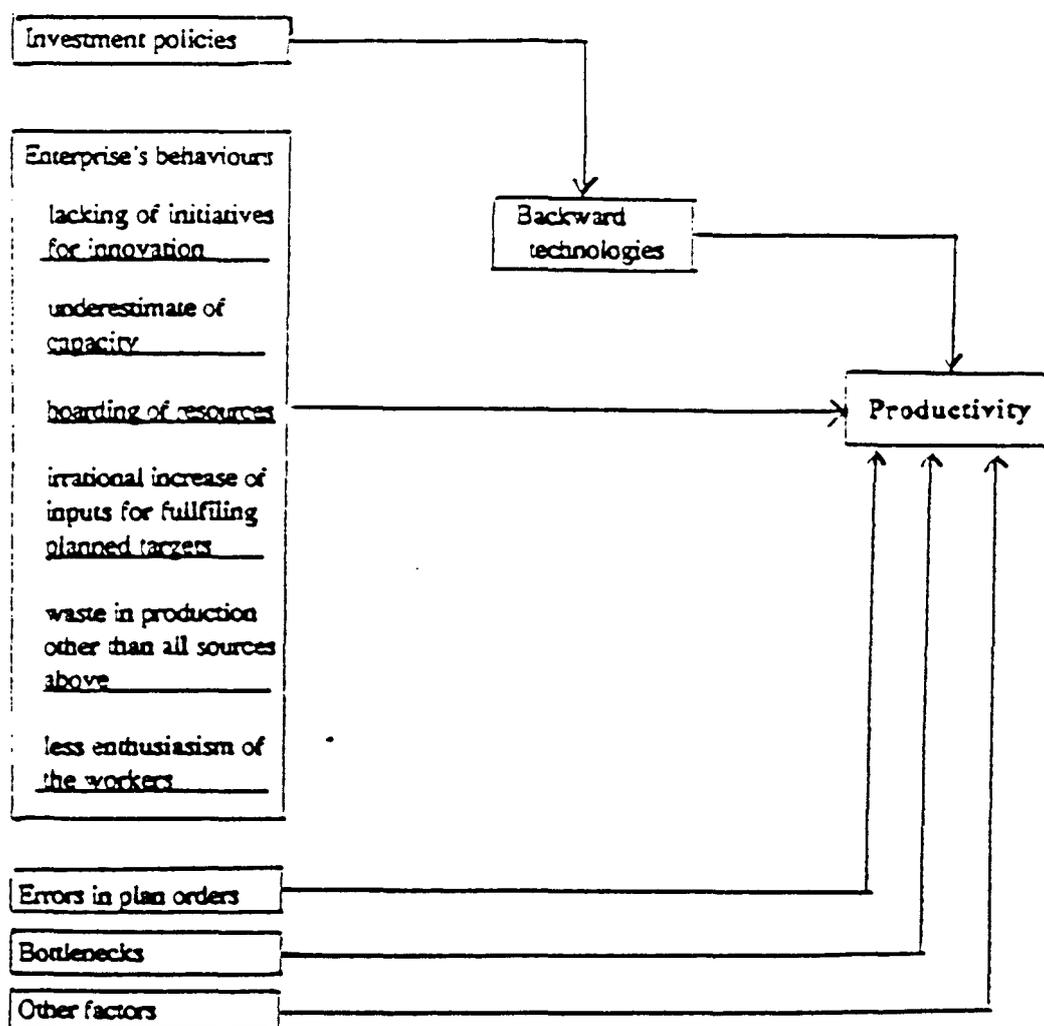
⁶ This was especially stressed by Prof. A. Nove when discussed with the present author on this issue.

acceptable and common criteria among economists for indicating technical efficiency in the use of productive resources (Bergerson & Levine, 1983). According to socialist economic theory, central planning and public (non-individual) ownership could provide more possibility for growth of productivity. Because the capacity of production can be fully used without limitations in the market economy, for instance, leaving some of the productive capacity aside due to recession or other difficulties for selling goods on the market. This assumption was agreed among some Western observers as well on the ground that, since the overwhelming goal of a Soviet-type economy was to grow the economy as fast as possible in a relative short period, the existing capacity of production thus must be put into full use or over-used under tight plans(Nove, 1986a). Moreover, the advanced technologies would be taken into the production process without difficulty if planners decided to, since there was no secrecy and consideration of cost which was necessary to be taken into account in this type of economy like in any market economy.

However, the reality showed a different picture in both economies. The data gave such a contrary answer that a centrally planned economy has not proved efficient at improving the technical efficiency of production. The economic waste in a planned economy was unbelievably huge (Tiusanen, 1991). As Wiles put it, “ the STE (Soviet-type economy)...is a better mobilizer than user. The input volume index grows more rapidly than elsewhere; but the FPR (Factor productivity residual) is not remarkable” (Wiles, 1977). This could explain partly the stagnation of the population’s living standard in China, as discussed earlier, apart from the over-fast growth of the population. Because reduced growth rate of productivity hindered economic growth. The crucial issue lay mainly in the nature of enterprises and the planability for allocation efficiency. The mechanisms working behind the productivity growth was more or less similar in the two economies, despite different backgrounds in the length

of the centrally planned system and other factors. Panel 3-2-1 may help us to summarise briefly the systemic factors that affect the improvement of productive efficiency in enterprises⁷. The planability of centralised planning system was discussed in a later section when the technical preconditions for planning control was dealt with.

Panel 3-2-1 Factors affecting productive efficiency of enterprises in CPEs



unbalanced development

If the final outcomes of productivity growth were against the planners' expectations, then the disproportion of the economic structures in the

⁷ For detailed discussion on this issue, there are a number of references, e.g., Winiecki, 1988; Komai, 1992; Gregory & Stuart, 1986.

centrally planned economy should be considered as the deliberate work of the planners. Both of our cases suggested this assumption.

It is interesting to note that in any textbook on socialist economics, a planned and proportionate development of the economy was described as one of basic principles and main characteristics of the planned economy. Because, it was said that only by planning could the economy achieve an ideal state. But, as a matter of fact, planners neglected this principle by selecting few sectors as priorities in making the national plans. These sectors were guaranteed a faster growth than others through privileges given to them in getting investment and other productive resources. In both economies, the priority sectors were heavy industry versus light industry; manufacturing branch versus mining; industry versus non-industrial sectors. As a result, the whole economy had been developing in an unbalanced way with the planners' preferences concentration on a few privileged sectors.

The distorted structure of the centrally planned economies was a built-in bias in the system as required by the extensive growth of the economy (Winiecki, 1988). However, the cost had to be finally paid. Disproportion of economic structures became one of the main factors handicapping the smooth and rapid growth of the economy in the Soviet Union after the mid-1970s, if not earlier. While in China the disease came relatively earlier in the period of its planned economy and threatened a further growth of the economy. This was because the legacy of the pre-communist economy was not so strong in China for it to bear the discrimination of the non-industrial sectors by supporting the rapid growth of the national economy with less investment and improvement, especially in agriculture. The problem expressed itself and gave the alarm to the society through the stagnation and deterioration of people's living standard in the first place. The survival of the large population

increased the significance of those lesser privileged sectors on the planners' list, and made for earlier recognition of the disproportion problem in the country than in the Soviet economy.

Consumption

The earlier study on the consumption sector in the Chinese and Soviet economies proved the well-known argument that in a centrally planned economy consumption was treated as the last one on the planners' priority list. The standard of consumption, both the collective and private consumption, was always kept at the minimum level, if possible, in the early period. And difficulties in consuming were not solved even when more income was distributed to people. Repressed inflation and shortage in CPEs greatly affected the improvement of people's living standard through consumption (Kornai, 1992; Winiecki, 1988).

Consumption had been a longstanding problem in China and the Soviet Union. It was not only a problem of a smaller share of consumption in distribution of national income which mainly occurred in the early stages of the economy. The nature of the problem was found in the shortage of consumers' goods and services, as well. Production of consumer goods was obviously sacrificed owing to the stress on production of producer goods in order to seek high growth rates for the economy. In the early stages of unbalanced development in the planned economy, planners carried out their policy through pressing the share of consumption to a minimal low level. People had to get the food and other necessities by ration because these items were in short supply. They were told they must suffer at present in order to be better-off in future. When the 'future' came, when people got increased income, which was a policy designed for incentive purposes in the Soviet economy, they still found it difficult to enjoy more consumption under the circumstances of shortage of supply and poor quality of consumers' goods and services.

The consumption phenomena in the two countries, in the Soviet Union in particular, posed two questions. First, if the increase of income was accompanied by increase of labour productivity and final goods, why could the goods not be got in the market? Second, if the prerequisite for increase of income was not true, how could it be the case?

From the analysis of the nature of state-owned enterprises in a centrally planned economy, it was not difficult to get such an impression that what concerned the managers most was to fulfil, or overfulfil, plan targets in volume terms so that extra income as the reward could be obtained, no matter whether or not the products were of fine quality or of a proper category to be sold on the market. Thus, when the awards were given, a number of final goods could only stay in the warehouses.

On the other hand, increase of income could be realised at a faster speed than that of the growth of labour productivity in a planned economy. On the one hand, the decision to raise disposable income would be made on the ground of false information about the growth of labour productivity in the same period, or without this sort of consideration when the planners thought it necessary. Everything would be possible just depending on the planners' orders, not on anything else. Then again, when the managers were given more decision-making power in this respect, they usually intended to raise wages of the staff for incentive purposes.

Technical issues for planning control

When we discussed the systemic factors which were responsible for the problems in the two economies, the noncompletion or poor performance of the planning control system must not escape blame. It was not unfair to say so in relation to the consequences brought by the incomplete planning control in the two economies. However, if one explored the

causes of such inefficient workings of the system, the charges on the system itself seemed unfair. On many occasions, planners could do nothing because of the insufficient equipments provided for their jobs. It was needless to point out the fact that centrally planned economy required technically advanced equipments and instruments in making and implementing plans. An efficient communication network and mechanisms for getting correct information from the periphery were also very essential.

The technical preconditions for proper planning work existed in at least the following requirements. The first and basic one was that the adequate and efficient equipment must be used by all planning organisations within the system so that the frequent and serious delays and errors could be avoided. The larger the scale of message volume planners had to deal with, the shorter the time allowed for finishing the work, the more advanced technical equipment which must be employed. The second requirement for competent control by planning was the communication net throughout the economy. Last but not least, correct and accurate information message to the central planners was crucial for proper working of planning system. This required not only physical conditions, though in China and the Soviet Union such factors troubled the efficient operation of the planning system. What was more important was the motivation of the periphery organisations to provide the correct information. Or, in other words, the central planning authorities must be, by any means, guaranteed to receive the correct information they needed for their job.

3.3 Reforming efforts in the past

For the main purpose of the subject of the present paper, i.e. the proposals for economic reforms in China and the Soviet Union in the

relevant periods, what concerned us here is, up to the late 1970s what had been tried or carried out in order to improve the performances of the centrally planned economies, not only confined to China and the Soviet Union but also in the other socialist economies like the East European countries. It was obvious that reform efforts in the past in either the Chinese or the former Soviet economy had failed to achieve their aims. This was why those longstanding problems discussed earlier in this chapter were still there, and new reform was necessary in the 1980s and 1990s. However, it was not the subject of this thesis to analyse why and how the previous reform efforts did not succeed. What was concerned here was what had been tried in the past in order to see any progress in the newly launched reforms.

3.3.1 Reforming attempts before 1978 in China

In the relative short history of the centrally planned economy in China, reforming or adjustment attempts had actually never stopped. In as early as the late 1950s, when the new planning system was established for about one five-year plan period, the disadvantages of over-centralised decision-making power at the centre was conceived. In 1957 some official documents⁹ were adopted for decentralisation of the decision-making power from the centre down to local authorities and enterprises. These proposals were implemented from 1958 on which could be perceived as the first wave of an administration-decentralisation-oriented reform in China. Local authorities were endorsed with more decision-making powers in their regions for things such as planning, investment, fiscal and taxation, and labour allocation. They also took over a number of large state-owned enterprises which used to be under direct supervision of the ministries, though they were still subject to plans. Central planning control on enterprises production was loosened through

⁹ In October, 1957, three drafts of reforming the systems of industrial management, commercial management and fiscal management were presented (Zhou, 1984).

allowing more autonomous rights to enterprise. Plan indicators were reduced in number. The enterprises could share the profit they made with the State, and they were given some rights to decide on personnel affairs in such undertakings.

But, the reformed state didn't last long. In the early 1960s when Chinese economy encountered a severe time, partly due to poor harvests in 1959 and 1960, a measure of recentralisation took place. The central control of large industrial enterprises which were under the supervision of the local authorities was restored. At the meantime planned control in agriculture and rural area was largely relaxed due to the severe reduction of growth in agricultural production. The way of organising production was changed from collective management to household contract⁹ and private plots were allowed for the peasant families. Furthermore, prices of state procurement of agricultural products were raised and tax levies on rural business reduced. In industries, material incentives were stressed for promoting higher labour productivity. All these measures contributed to recovering economic growth and the living standard from the difficult early 1960s (Brugger, 1981). However, all these measures were not taken as the ones of economic reform. As mentioned above, they were considered officially as the short-term methods to cope with difficulties in the economy.

The second wave of official reform effort occurred in the late 1960s. During 1966-76, the ten years 'Cultural Revolution', economic reform became a political matter. Decentralisation of the decision-making powers from the centre to local governments was repeated. But there was no careful design and plan for this reform. It was mainly the result of a political movement in the country where the central agencies were knocked down (Zhou, 1984).

⁹ The household contract at that time became the original form in the newly launched reform in late 1970s which was discussed in due course in this thesis.

It seemed safe to say that there had been no well-prepared economic reform on the planning system in China, except repeated redistribution of the authorities between the centre and the local agencies now and then. But the experience in rural reform in the early 1960s played some part in the history which was followed in the newly launched reform under our discussion.

3.3.2 Economic reforms before 1985 in the Soviet Union.

In the Soviet Union, there was more to be discussed than in China's case as the situation was different. Here the brief analysis was limited to the post-war period after Stalin. In this period two large scale reforms on the centrally planned economy took place. They were Khrushchev's reform and Kosygin's reform under Brezhnev.

Khrushchev's reform had been summarised as a kind of *sovnarkhoz*¹⁰ reform since its focus was put on reorganisation of the administrative agencies from ministries to territorial production administrations for the purpose of improving the efficiency of management by planning control. However, much had been tried in the agricultural sector in this round of reform. The essence of the measures in agriculture was in increasing prices for state procurement, allowing and encouraging private plots for peasants and increasing inputs and investments. *Kolkhozes* were given more freedom to make decisions (Nove, 1986b).

The most influential economic reform in the Soviet Union before Gorbachev's era was launched in Brezhnev's regime in the mid-1960s-- the 1965 Kosygin reform. Relatively speaking, it was a well-prepared reform. Some substantial proposals were put forward during this round of reform. The major points intended could be summed up as follows.

¹⁰ In Russian, *Sovnarkhoz* means territorial administration organisation.

Firstly, it restored the central (Moscow) control of the economy by dismantling the territorial organisations. Ministries were re-established (Nove, 1986b). The focus of Kosygin's reform was put on improving economic efficiency in the country. The performance indicators of the enterprises were reduced in number and revised in content to give more managerial powers for decision-making¹¹. Another major step in the 1965 reform was on the charge of fixed assets of the enterprises at the average rate of 6 percent for more efficient use (Nove, 1986b).

In the early 1980s, before Gorbachev took power, economic reform in the Soviet Union seemed to be declining from the tide of the mid-1960s. But the contribution of Andropov in determinedly calling for changes in the traditional economic system should not be ignored, though no substantial proposals took place in his very short period.

In summary, the centrally planned system in China and the Soviet Union have been more or less modified from the original type. But the nature and basics of the system remained intact. In both countries there had been no attempt for a departure from the essentials of the centrally planned economy.

3.3.3 Experiences of East European countries up to the late 1970s ¹²

East European countries¹³ shared the same type of economic system with the Soviet Union and China up to late 1980s. But they felt much earlier on the difficulties endemic to the centrally planned economy than the

¹¹ The remained indicators set by central planning authorities were, the volume of goods to be sold; the main assortment of goods; the wage fund; the amount of profits and level of profitableness; payment into the state budget and allocations from the state budget (Kosygin, 1965).

¹² This section was based on the works of Adam (1989), Bornstein (1977), and Kaser (1986).

¹³ For conventional purpose, Yugoslavia is included in this group of countries here, although it departed from the block politically in the early 1950s.

Soviet Union and China. This was because these small but developed countries could not sustain the extensive growth for a long term. In fact, the great achievement and experiences in reforming the centrally planned economies were realised in groups of these countries like Yugoslavia, Poland, Hungary and others. For the purpose of this paper, it was necessary to cover briefly what had been attempted in this field in order to assess the processes in China and the Soviet Union under the primary discussion.

To a large extent, reform ideas and efforts in centrally planned economies had been attempted as the ones of decentralising the decision-making structure. In most cases, decentralisation, both administrative and economic, was the essential content of economic reforms in East European countries. For example, decision-making powers of central ministries and planning agencies were weakened. Some of them were transferred down to lower authorities, associations, for example, or to enterprises. Administrative reorganisation occurred as the result of decentralisation in many East European countries. Reducing centrally set output plans, or abolishing them, was the common action taken by reformers. Enterprises were normally given more autonomous rights in various aspects of business.

With decentralisation of decision-making power from the centre to the intermediate and periphery, the information flow direction changed at the meantime. More messages went in a horizontal way, for instance, the contacts between enterprises increased. What was more relevant was the tendency of reforming efforts towards marketisation. Two primary achievements in this field were outstanding. One was the mechanism for setting prices. The other one was the method for allocating input resources. In some countries like Hungary, prices for some consumers' goods and services were no longer fixed by state agency, but formed on

the market and fluctuated according to the demand situation. As to the distribution of material inputs, some radical measures called for eliminating administrative allocation by planning quota and introducing contracts between suppliers and customers in a market framework.

As far as ownership was concerned, small sized private business in certain and limited sectors of the economy was permitted, mainly in service and handicraft. No substantial attempt was conducted on changing the non-individual ownership of the state sector.

In agriculture, reform went further than in other sectors. In Poland, decollectivisation took place in the 1950s.

Generally speaking, economic reforms in East European countries started earlier and went deeper than China and the Soviet Union. But practical progress in changing the traditional economic system in those countries was much less than the paper plans, many of which could not be implemented for political reasons. In summary, the reforming efforts in centrally planned economies before 1980s had never gone beyond the moderate adjustment in the sense that no attempt had been made to transform the planned economy into a non-planned economy. This was especially true in the case of our two economies.

3.4 Political background

This thesis was, as pointed out in the introduction(Chapter One), focused on the economic proposals for transformation of the planned economies of China and the Soviet Union. However, as is well known, any decision on economic reform in these countries, the large scale and radical reforms in particular, could never be separated from political and social factors, . In other words, in the centrally planned economies, where one

party dictated the society, non-economic factors played crucial, sometimes decisive, roles in the decisions about an economic reform, e.g. what direction would the reform go and how to carry out the reform and so on. To be specific, discussions on reform affairs had never been the pure academic matter for economists in China and the Soviet Union. It was rather a political matter decided at the top level of the leadership. Apart from this, social environment and the attitudes of the people also influenced the process of the reform by promoting or obstructing it. So it was necessary to introduce briefly the political background against which the economic reforms were discussed in the two countries for a sound understanding of the process of the transformation. Because the attitude and determination of the top leadership of the Party and government towards economic reform in the two countries was of significance.

It was interesting to note that China's radical reform was initiated almost immediately after the official announcement ending the "Cultural Revolution" which came to its end on the death of Mao Zedong. In the Soviet Union M. Gorbachev took power shortly after the long Brezhnev regime. Under the old long time regime, the ignorance of the severity of the economic problems, the inertia and reluctance in taking effective reforming actions, or more relevant, the ideological constraints etc. obstructed and postponed the necessary reforms. Once such a regime was brought to an end by the death of the top leaders, the chance was born for any possible and positive change in the economy and society (Kornai, 1992). Fortunately, the chances were taken promptly in the two countries by the leaderships of Deng Xiaoping and Mikhail Gorbachev.

To launch and lead the radical reform surviving through the process, the powers of reformers played a critical part. The posts the reformers held in the Party and government leading bodies in the centralised and

hierarchical society were crucial to guarantee the working out and implementation of radical reform proposals. It was only authorised by the top leadership of the Party and government that any proposal could become decree and official policy for being followed in the planned economy. Furthermore, reformers must be able to overcome all forces from the opposite side against the radical reform. On these occasions personal power mattered. In our case, it seemed that Deng Xiaoping, -- the paramount leader in China without proper status or any official title from the late 1980s, -- was more able to exercise decisive personal influence on the process of the economic reform in China than Gorbachev in his country. This was because in the Soviet Union, the People's Congress played more and more part in the political life of the country. Gorbachev therefore had to move this mountain, in the first instance, to approve and pass any practical reform legislation.

The strong motive of the reformers in China and the Soviet Union was also generated from the longstanding ambition of the communist leaders to catch up with the advanced capitalist economies and strengthen their own countries as the world great powers in political, economical and military affairs. In the Soviet Union the dream was realised only partially in some of the defence fields, while the economic power was still lagging far behind its competitors. In the mid-1980s even those advances gained were in danger of being lost due to poor results in economic growth (Joint Economic Committee, 1982). In China, things had been far less satisfactory, if one was reminded of the ambition expressed by the slogans such as "surpass United Kingdom and catch up with the United States within 15 years!" put forward in the late 1950s. The Chinese and Soviet leaders were very sensitive to the results of the relevant comparisons of economic indicators, e.g. those between China and Japan, and between the Soviet Union and U.S.A.

Political struggles between the reformers and conservatives(the left) at the top and below could be reflected from the process of the discussions about the economic reforms, as one might find out in the context of our further analysis.

Chapter 4: Prescriptions For China's Economy, 1978--1992

The period from the late 1970s onwards witnessed some of the greatest historical changes, primarily economical, though political as well, since the communist revolution of 1949. In 1976 Mao Zedong, until then the paramount leader of China, died. Shortly afterwards, his wife, Jiang Qing, and the other members of the "Gang of Four" were arrested. Deng Xiaoping immediately returned to political life. Although it took some years for him to assume the top position in the Chinese leadership, he and his supporters began to implement their reformist economic programme. At the end of 1978 during the Third Plenum of the Central Committee of the 11th Party Congress of the Chinese Communist Party, Deng Xiaoping made a speech about the urgent necessity of reforming the existing centrally planned economic system (The State Committee for Reform of the Economic System, 1988b). During the discussion it was pointed out that the existing system over-concentrated national decision-making powers at the centre, which resulted in inefficiency in the economy. Policy adjustment and reform in agriculture in particular were discussed. From that time on, a series of reform proposals were put on the agenda for discussion and implementation by the Party and the government.

During the 1980s Chinese reformers called repeatedly for reductions in administrative interventions in the economy, for greater reliance on economic "levers", for the decentralisation of economic decision-making, and for an increased role for market forces. At the same time there were debates between moderate and radical reformers. The moderate school led by Chen Yun advocated that China should move towards a system where a "planned economy is primary, and markets are supplementary" (*Jihua Jingji Wei Zhu, Shichang Tiaojie Wei Fu*) (Beijing Review, 1985). Others

proposed that China should move beyond the moderate's vision to a system where, in fact if not in name, the economy would be regulated primarily by market forces. Official decisions were always compromises between the two groups. The aim of reform in general was "to transform the function of the state planning organs, gradually reduce mandatory planning and expand guidance planning," and "to use economic instruments, and gradually establish a new economic mechanism where the state regulates markets, and markets guide enterprises" (*guojia tiaojie shichang, shichang yindao qiye.*) (Wu Jinglian, 1988). Generally speaking, Chinese economic reform has been a process of gradual progress from moderate adjustment of the centralised planning system to radical transformation towards a market-oriented economy with socialist characteristics, which will be discussed in detail in this chapter.

The process of reform in China since 1978 can be viewed as taking place in four stages in the sense that packages of proposals were presented in various mixes of moderate and radical reform. The initial period, i.e., 1978-84, witnessed proposals biased towards primarily sectoral issues. In 1985-89 a larger scale discussion on economic reform produced proposals for comprehensive initiatives to alter systematically the planned economy as a whole. After the events of Tiananmen Square in June 1989, economic reform came to a standstill for about two years. Until 1991 little discussion took place on continuing the plans made in the years before 1989, let alone suggesting further reform. It was only from late 1991 that the voice of the reformers began to be heard again in public. Of all the statements made, Deng Xiaoping's speech while inspecting Guangdong Province and especially Shenzhen was the most significant in revitalising radical economic reform in the country. 1992 saw a gradual advance by the reformers, culminating in 14th Party Congress of the CCP in November.

Of course, economic reform in China from the late 1970s to the early 1990s was played out against a changing political and social background (Burton, 1990). The general political situation was stable, apart from the events of Tiananmen Square (Chan, 1991). Nevertheless, behind the scenes there were power struggles and important personnel changes within the top leadership of the CCP and of the government, even before June 1989. And it was into the Winter of 1991-92 before the political situation at the top was sufficiently resolved for economic reform to regain its momentum, signalled by Deng Xiaoping's inspection tour of Southern China.

Reviewing more than a decade's reforming efforts in the light of critical official documents and important discussions, the author has structured this chapter in the following manner. First of all, the proposals for sectors of the economy are studied, because these gave significant momentum to the whole process and were the actual starting point of the economic reform. The issues in this first section are the reform designs and decrees for agricultural production and the rural economy, the open door policy and foreign economic activities, and the changes in state-owned industrial enterprises. However, some points of the discussion concerning the state-owned industrial enterprises are left to the second section where an analysis of the comprehensive blueprints for reform is the main topic. In that section, the main features of the model of the economic system designed by the reformers are briefly surveyed. For instance, what orientation was intended, market or combination of planning and market? What was the proposed status of the state-owned enterprises, the backbone of the planned economy? Key aspects of the complete blueprints for changing the whole system are analysed in details, including central planning control, state-owned enterprises and market mechanism. The principal points of the

proposals for economic reform after the events of Tiananmen Square are examined in a concise way in the third section of this chapter, with the focus on the discussion after 1991, though in a general manner. It is in the fourth section that the depth and width of the economic reform in China is analysed in the language of theoretical assumptions, and along with a general description of the major features of the Chinese-type economic system. Finally, of course, a conclusion is drawn on the extent of the endeavour put into reforming the centrally planned economic system in China during the whole period. For logical and technical considerations, some discussions and in particular some conclusions, are left to Chapter Six where the comparative study of the economic reforms in China and the former Soviet Union is conducted.

4.1 Sectoral reform efforts

As is well known, economic reform in China started with the rural sector of the economy. However, reform efforts in the urban area, on state-owned industrial enterprises in particular, was more important owing to its central role in the national economy. The opening-up policy precipitated dramatic changes not only in the foreign trade sector but also in the entire national economy, which, under Mao's regime, had been almost completely isolated from the outside world--especially from the Western market economies. Last but not least, a growing private sector mushroomed in both rural and urban areas. These four areas of reform from 1978 to the late 1980s, i.e., the rural sector, the state-owned industrial enterprises, foreign trade and the private sector, are the subject of this section.

4.1.1 Rural economy

It was logical that agricultural production became the top priority on the reforming agenda in China if one looks at the situation discussed in Chapter Three. In a large country where the rural population still accounts for about 80% of the total population, the development of agriculture to large extent determined growth in other sectors of the economy. In addition, Chinese leaders could no longer ignore the crying of the peasants in face of the difficulties and problems that occurred in agriculture in the late 1970s. This is why the initial breakthrough in economic reform occurred in agriculture.

In general the reform efforts in agriculture after 1978 were aimed at reducing direct interventions in planning and pricing. The importance of direct planning of production and procurement was reduced, and prices, incentives and market forces were increasingly relied on by the government to guide the rural sector. Specific measures included reductions in state planning of agricultural production, commerce and pricing; decentralisation of decision-making authority to local governments and producers; greater leniency towards and encouragement of free market exchanges; and increased reliance on market prices.

The reform of the system and mechanism of organising agricultural production and related matters came gradually with time. At the Third Plenum of the Central Committee of the CCP in 1978 two important policy decisions were approved: (a) to increase the government's purchase price of farm produce by an average of 24.8%; (b) to recognise the rights of production teams to self-management. In the early stages, attention was paid to this sector in order to increase its share of centrally allocated investment and so to improve its performance. But one specially important step was taken. This was the policy of increasing prices for agricultural

products. The government raised the prices it paid for farm products by a considerable margin starting with the summer crop in 1979, and it allowed a further 50% premium on the portion of products sold above its targets (The State Committee for Reform of the Economic System, 1988b). After 1979 all farm products, with the exception of cotton, could be sold on the free market. Prices there were even higher than the premium prices. Therefore, three price levels existed at the same time: official, premium and free market. In addition, the share of compulsory purchase of agricultural products by the State was for a long time kept constant at the level of the period 1971--75, which meant that it was automatically raised with the increase in production. Furthermore, up to 2.5 billion kg of grain was to be deducted from the state purchase quota (The State Committee For Reform of the Economic System, 1988b). All these measures indicated beginning of a process of changing the traditional planned management system of agricultural production. Given this situation, the farmers devised every possible means to reduce sales at official prices. In 1979 the government purchased 31.50 million tons of grain at the official price under the compulsory supply system, but by 1981 this had fallen by as much as 23%, to 24.32 million tons. By 1985 the government used official prices for only 30% of its purchase of grains (Kojima, 1988)

There were two major stages in reforming the rural sector. From 1978 to 1984, restructuring was promoted through institutional change based on the decentralisation of farming operations. To achieve this, a series of policies were put into operation aimed at establishing the household responsibility system, reforming the peoples' commune structure, diversifying the agricultural and rural economies and creating specialised households, and adjusting prices, taxes and quotas (Wang & Zhu, 1987). In the second stage, i.e., from 1985 on, reform was directed towards marketisation and

privatisation. State monopoly purchase of agricultural produce was reduced and the role of prices and markets increased. Land-leasing terms were extended from three to five years and then to fifteen (Zhu & Fan, 1989). Rural industries, principally collective or individual ownership, mushroomed. Reform of the rural sector was deemed so important a position that every year from 1983 the number one document of the central committee of the CCP was about agriculture (Kojima, 1988).

The household responsibility system, or the production responsibility system, was the most impressive measure for restructuring the rural economy. It was not new, because it occurred for a time in the early 1960s (Donnithorne, 1967). And in fact, up to late 1981, the reorganisation of the agricultural production responsibility system (*Nongye Shenchan Zeren Zhi*) was largely limited to the restoration, or refinement of the work-point system (The State Committee For Reform of the Economic System, 1988b). Document No.1, 1984 consolidated the gains achieved since 1978 in transforming rural organisation (Wang & Zhu, 1987). And from 1984 on, the household responsibility system in various forms established its position as the primary organisational form of agricultural production.

The household responsibility system takes various forms. But the principle behind the reform were uniformity. The pre-reform organisation of agricultural production saw masses of labour working on collective land, organised by the brigade, commune or even higher authority, and following assignments issued directly from the local planning agency, and indirectly from the central planning authority, depending on the importance of the products (Blecher, 1988). This system was replaced by individual labour working on land leased from the village authority (the former brigade). There was still compulsory selling to the state of a certain

share of the production of the household or group at state-set planned prices. But any quantity of the products remaining could be sold on the free market. The decisions about production, i.e., what, how and how much to grow or raise, were at the discretion of the farmers in the household. No other planning interference than for the requirements listed above was supposed to be in effect (Wang & Zhu, 1987). In other words, the responsibility system in agricultural production in its early stage was a process of decollectivisation in the organising and disposal of production. In terms of economic reform, the responsibility system was an effort partially to decentralise decision-making power. Perhaps more significant was the change in motivation. Because leasing by the state, still the 'owner' of the land, took into consideration the productive capability of the soil it favoured the farmers. The more they produced, the more they could claim as their own.

From 1984 onwards the development of the responsibility system came into full swing, the so-called late phases of the process. When the time for which land could be leased was extended from less than three years in the early 1980s to fifteen years or even longer, together with other new policies, the essence of the system of organising agricultural production seemed to be radically altered (Kornai, 1992). In terms of technically arranging production, farmers now virtually "own" the land, though they are not authorised to sell it. What they are allowed to do is through official arrangement to transfer any unwanted land to other farmers who do want it (Zhu & Fan, 1989). This surely flies in the face of orthodox communist ideology and the impact has been profound. Document No.1, 1983, permitted "labour swapping between farm families" and "families which have lost their labourers or which are short of labour, to employ occasional farm workers for the purpose of maintaining their living" (Wang & Zhu,

1987). No matter how modest these initial stipulations may sound, their subsequent implementation led to a full-fledged endorsement in Document No.1, 1984, of virtually unlimited transfer of leasehold rights (Wang & Zhu, 1987). It is, therefore, not unreasonable to say that a private economy operating under market conditions was well on its way in China's agricultural sector. The fact that the remnants of planned control were largely eliminated with a series of measures strengthens the argument. As a result of these measures, 1) the share of production taken up by state purchase was reduced substantially; 2) from 1985 onwards, state procurement of grain and cotton became no longer a compulsory requirement, but the subject of contracts between the state and the farmers; 3) for other items like pork, seafood and vegetables, there was eventually no state buying, and they were sold at free prices (Zhu & Fan, 1989). Although there was no detailed statement at the time about when these measures would come into effect, they very soon did.

With this alteration in the fundamental way of organising production other related mechanisms and policy instruments came on to the agenda for change. For example, the system of trading was adapted to the new requirements. An appeal was made to accelerate the decontrol of the entire rural supplies and sales cooperative networks, the cooperative shops, which curiously had been converted into state ownership as late as 1978 (Solinger, 1984). The ownership of the cooperative shops was gradually transformed in the mid-1980s into share-holding or partnership undertakings owned by individuals (Zhu & Fan, 1989). They could no longer be subordinated to the state-owned commercial agencies, which must negotiate with the farmers about the prices of goods before contracts are signed. Changes also came about in credit and banking involved in rural affairs. Rural credit cooperatives, which saw both their deposits and

their loans increased tremendously, as a result of creeping decollectivisation and rising peasant incomes, were given greater powers in financing rural industrial/commercial activities and the freedom to change their interest rates. Some small credit societies, transforming from existing ones or newly established, began to exercise the functions of a bank or similar financial institution. They were no longer, as they appeared on paper, the lower echelons of the state-owned Agriculture Bank --which is not a bank at all(Zhu & Fan, 1989). At the same time, private banking agencies were permitted among farmers for the purpose of supporting the rural economy. Moreover, rural industries owned by private individuals and institutions were greatly encouraged and grew rapidly (Byrd & Lin, 1990).

In all these ways Document No.1, 1984, marked a new phase in the rural reform in China. It effectively set the stage for further growth of the rural economy by generating confidence as to the durability of the new system. Apart from this, more new policies were put in place to provide further freedom for peasants to engage in business other than farming. Rural industries and associated activities mushroomed as a result. The number of industrial enterprises increased tenfold between 1983 and 1985, and rose 50% more by 1988. The number of employees more than doubled between 1983 and 1985 and increased by 27% more by 1988. By the late 1980s rural industrial output was about 25% of the national total ((Zweig, 1991). As is discussed in detail in the next section, this played great part in promoting China's export trade.

4.1.2 Opening-up policy and foreign trade

Among other changes, opening up to the outside world was proposed by

the reformers immediately after Deng Xiaoping reemerged at the top of the leadership in the late 1970s. This had far-reaching implications for the transformation of the planned economy. The reforms undertaken after 1978 in the sphere of foreign economic policy greatly increased China's interaction with the international economy. In contrast to the period from the 1960s to the mid-1970s, China welcomed direct foreign investments; it accepted aid, loans, and credits from foreign governments, international organisations and commercial banks, and it multiplied the channels through which it hoped to acquire advanced technological know-how and managerial experience. In addition, Chinese reformers accepted the proposition that a universal set of international economic mechanisms and instruments exists, which China should learn to employ. In opening its doors to the rest of the world, therefore, China abandoned its belief of restricting economic and technological ties solely to other socialist countries and limiting international economic relations to the methods and strategies customarily employed by other socialist states. After all, the objectives in opening to the West were to attract hard currency investment and up to date technologies; to improve domestic production and to promote exporting capability (Cannon, 1988). And what was particularly significant was that these objectives were really intended to introduce market factors into China's domestic economy, literally by open door, but in a sense by the back door..

The establishment of special economic zones and the elaboration of favourable policies for business with foreign countries in some coastal cities were the main operational results of the open-door policy. As early as 1980, regulations were issued for establishing special economic zones in Guangdong Province (Wang &Zhu, 1987). In its first and, in the end, most far-reaching measure in 1979, China designated four areas along the

southeast coast--Shenzhen, Zhuhai, Xiamen, and Shantou--as “special economic zones” (Wang & Zhu, 1987). This first group was located near Hong Kong, from where increasing trade and investment was expected, and was specifically intended to encourage foreign investment in export projects. The government built modern physical infrastructures, provided well-trained labour, and offered preferential tax rates, exemptions and holidays. All four of these are coastal cities, with relatively convenient access to ocean transport routes. Two, Xiamen and Shantou, were selected partly because of their links with large overseas Chinese communities that could become sources of investment capital. All four were ‘special’ in the sense that, although on some occasions the central or local planning authorities could interfere with planning instructions, the fundamental driving force was the market; foreign companies and joint ventures constituted the main forms of undertaking; the export of goods and services to the world market was the over-riding goal; and consequently, the local authorities were granted much more extensive powers in managing and supporting these activities (Phillips & Yeh, 1989). Another important function of these zones was to serve as mechanisms for the introduction, study, and absorption of technology into a wider range of industries than in most processing-exporting zones elsewhere in the world (Harding, 1987).

Finally, the special economic zones were also meant to be arenas for testing economic and social reforms considered too radical or too experimental for the rest of the country. Over the whole period since 1979 Shenzhen, in particular, has progressed further toward a market economy than any other part of China.

In 1984, following the success of the few Southern special economic zones, fourteen cities along the coast from the North East to the South were

permitted to offer tax incentives for foreign investment similar to, although less generous than, the inducements offered in the economic zones. (Beijing Review, Apr.16, 1984) They were also encouraged to establish economic and technical development areas, usually in their suburbs, which were allowed to offer tax incentives to investors that were practically identical to those provided in the zones. By the middle of 1986, many provinces were also allowed to offer tax exemptions, reductions, or holidays to targeted foreign ventures (Beijing Review, Apr.16, 1984). Local governments in the fourteen cities also got power greater than their counterparts in closed areas but less than in the zones to make decisions relevant to regulating foreign business.

With the broadening of the open-door policy, three “development triangles” in southeastern and central China--the Yangzi River delta, the Pearl River delta, and the delta area around Shamen, Zhangzhou and Quanzhou--were identified as trade and investment promotion areas. (Beijing Review, Jan.19, 1987). These triangles comprised thirteen cities, forty six counties and two towns, and they were given the same privileges as the fourteen coastal cities. Like the special economic zones, they were to be a base for exports and a “filter to digest modern science and technology and advanced managerial methods... so as to discard the dross and select the essential ” (Harding, 1987). But the main emphasis of the triangles was not to be on technology-intensive manufacturing, as in the special economic zones or the economic and technical development areas in the coastal cities, but rather on growing and processing the agricultural products that could be sold on international markets.

In 1988, the Chinese government went further and decided to set up a special province on Hainan Island in the South China Sea (Zhu & Fan,

1989). The provincial government of Hainan was to be fully independent on all economic and domestic matters, except those involving in particular public security, customs and civilian transportation. It is undoubtedly obvious that a quasi-free market economy experiment was intended in Hainan's case because the purpose elaborated for the new province is, in the near future, to develop an internationally oriented investment economy like Hong Kong.

Reform of the traditional foreign trade system in China's planned economy was one of the areas where action was taken earlier than elsewhere in the economy. For example, in the late 1970s, the State Council had promulgated a series of reforms, some of which--such as the law on joint ventures-- were dramatic. They included a decentralisation of foreign trade authority, a reduction in the degree to which the official exchange rate overvalued the domestic currency and a reduction in direct import subsidies. The latter two measures tended to bring the price of imports more into line with their true economic cost. Simultaneously the State Council reduced the scope of the national foreign trade plan (Lardy, 1992b).

As part of foreign trade system reform, many new forms of trade were introduced. Among the most important were the export processing and compensation trades, which was believed to take the advantage of cheap labour in the rural areas in particular. Exporting oriented enterprises in the rural areas were greatly encouraged, no matter how small they were. In fact, a large number of township and village enterprises in Southern Chinese countryside were established aiming at producing for exporting. As a result, non-state owned undertakings, including collective township enterprises and joint ventures played a significant part in expanding foreign

earnings.¹

Last but not least, the so-called Overseas Chinese played an important role in the rapid growth of the external economy. Capital investment and specific projects from Hong Kong, Taiwan, Singapore and Chinese communities in North America and elsewhere were the first and the most important contributions to the early growth of foreign business. Hong Kong, in particular, became a major entrepot through which China could sell exports and procure imports. Its share of China's trade rose from about 11% in 1978 to 22% to 23% in the mid-1980s. Of Chinese exports to Hong Kong, only about 40% were used in the territory, while the remaining 60% were re-exported to third countries. Similarly, about 75% of China's imports from Hong Kong came from outside the territory, including from trading partners, such as Taiwan and South Korea, with whom China had no diplomatic or direct economic relations in the 1980s.²

With the opening-up policy, foreign trade became more and more important in the national economic development of China. In contrast to the mid-1970s, let it alone the 1960s, a significant part of the whole economy is involved in external activity now. The growth of foreign trade in China was among the fastest of any country in the 1980s, and as a result China has become one of the major trading powers in the world. In 1978,

¹ The below table shows the growth of exports by rural and joint venture enterprises in 1985-1991. (Lardy, 1992 a)

	Rural enterprises	Joint ventures enterprises
1985	3.9	0.3
1986	4.5	0.5
1987	5.1	1.2
1988	8.0	2.5
1989	10.1	4.9
1990	12.5	7.8
1991	—	12.1

² Diplomatic relation between China and South Korea was established in 1993.

China's rank on the list of world major trading powers was at the 32th. In the 1990s it rose to the 11th (Beijing Review, 1993).

The measures adopted to produce this result are of particular interest here because they indicate the tendency towards reforming the centrally planned economy. First of all, they brought about to some degree the decentralisation of decision-making powers concerning foreign economic activities. Secondly, the economic mechanism in the various 'special' areas became increasingly market oriented; and in some cases marketisation of the regional economy can be expected in due course. Finally, the influence of large-scale foreign business building up in a relatively short time were far from negligible in the development of economic reform and the national economy as a whole (State Committee for Reform of the Economic System, 1988b).

4.1.3 State-owned industrial enterprises: a brief look

Reforming the state-owned industrial enterprises to a large extent meant changing the nature of the central planning system, because this sector constituted its core. It could not, therefore, be expected to be along as simple and straightforward lines as in other sectors already discussed. Unlike rural changes, industrial reforms provided little clear-cut evidence of success in increasing efficiency or reorienting production the better to match demand. The depth of the reforming attempts was restricted in various ways by more complicated factors, for example, than in agriculture (Brus & Laski, 1989). Some issues in this sector have to be studied in the context of the overall design of the economic reform, as is done in next section of this chapter.

In general, the policy of improving the efficiency of state-owned enterprises was limited by the partial decentralisation of certain decision-making powers, the so-called autonomous rights of the enterprise. From late 1979 down to early 1984, the reforming process went through three overlapping phases. First, there was a restoration of the “enterprise fund” system. Secondly, the profit retention system was introduced of which there were at least two major versions, one in 1979, the other in 1983. Thirdly, experiments with the “substitution of taxation for profit remittance” (*yi li dai shui*) began in 1980 but was considerably expanded in 1983. These various changes in policy were directed towards decentralisation of power from the state to the enterprise level, especially in the financial arena. However, reform efforts in the state-owned industrial enterprises did not really get beyond the experimental stage (Bureau of Enterprises, 1988). Only a small number of the enterprises was put on the list of reforming places in order to observe the effects and consequences. Two important documents discussed the experiments and set down the rules for those enterprises engaged in them (Wang & Zhu, 1987). Among other things, the rules covered the distribution of the revenue of the enterprises and their financing as shown in the following examples. (1) Instead of turning over all the profit made by the enterprise to the state, a certain share of it could be retained and used for the purpose of further development of production capacity or improvement of production technology. The amount of the profit left to the enterprises varied according to each individual case. (2) For some enterprises, a new rule was established for profit disposal. Taxes including business tax, assets tax and income tax would take the place of profit turnover. That is to say, enterprises would stop handing over their profit to the state but instead pay various categories of tax. The relationship between the state and the enterprises would thus be altered. They were to be encouraged to become gradually self-financing after tax.

(3) Other enterprises were given the full right to dispose of the funds remaining to them from profit-sharing with the state. Higher authorities could neither take away part of the fund, nor interfere in how the enterprises chose to spend it. (4) Enterprises were to pay for their fixed assets and apply for bank loans to meet their current expenditures. (5) To some extent, enterprises would be able to make their own production plans on the basis of the directive and non-directive planning norms issued by higher authorities, taking into account demand and supply on the market. And they could adjust or revise the plan if necessary. In addition, after fulfilling planned production, enterprises were to be allowed to produce extra goods and sell them at planned or flexible prices--the latter being a price in between the planned and the market price-- according to individual cases. (6) Related to this rule, enterprises were given the right to set prices for the goods produced above the planned quota. However, first of all, flexible prices could only go downward. Secondly, only those goods which were in surplus supply, or with excessively high prices, could be priced at flexible rates. Finally, the State pricing authority would define the limit of flexibility, e.g, a percentage of deviation from the planned price (Wang & Zhu, 1987).

After 1984, the reforming endeavour in industrial enterprises was moved from the laboratory into practice. A decree was published by the State Council to extend the measures listed above to a majority of the state-owned enterprises (Bureau of Enterprises, 1988). Enterprises were also given decision-making powers on other important issues. For instance, the numbers and categories of goods that could be sold on their own initiative were increased. Within a limit of 20% above or below fixed planned prices, enterprises could sell non-planned goods at flexible prices. Enterprises were also able to choose where they bought their supplies.

Furthermore, enterprises were allowed to let or sell their idle or spare productive assets, but they were required to invest the income in improving technology and renewing equipments(Wang & Zhu, 1987).

Remarkable progress in the reform of the industrial sector came in the effort to apply the contract responsibility system after 1984(Bureau of Enterprises, 1988). The name and purpose were conceived as the same as in the agricultural sector. Notwithstanding, the content seemed quite different since more complicated relations and sophisticated technology were involved. In theory, the contract responsibility system was intended to play the role of a comprehensive prescription for remedying the traditional diseases in managing industrial undertakings(The Capital Steel & Iron Company, 1988). It was at least an attempt to decentralise some of the decision-making from the top authorities and administrative institutions down to the enterprises. Enterprises were to negotiate with the state the share or the amount of their profits that should submit to it. To enterprises working at loss, the profit-sharing was to take the form of a fixed amount of loss for which the state would be responsible, and after which the enterprises themselves would be responsible; and in the case that they made a profit, they would be allowed to retain it. Of course, the terms of the contracts of responsibility could not be uniform since each was determined by bargaining.(Wu, 1988). In fact, the new system affected mainly the distribution of the enterprises' revenue and their self-financing ability.

As far as ownership reform was concerned, there were two propositions. (a) State enterprises could be leased to individuals or, more commonly to groups of workers, for terms of three to six years. Potential lessees had to secure backing from financial guarantors and pass an examination of their managerial skills. During that period, in return for regular lease payments

to the state, they would acquire full power over the operations and personnel. By mid-1987, about three thousand state enterprises had been transferred to new management through some form of leasing (Harding, 1987) (b) For larger state enterprises, reformers proposed a second ownership reform scheme known as *Gufenhua*, which can be translated into English accurately, if rather awkwardly, as “stockification”. Under this scheme, ownership would be vested in shares, which would then be assigned or sold to various government agencies and public organisations, to enterprise workers, and to individual citizens who would then elect a board of directors to appoint and supervise the enterprise manager (Harding, 1987)

Before the discussing comprehensive economic reform, which included various issues to do with state-owned industrial enterprises, a brief summary of the discussions above is necessary because in the next section sectoral issues are excluded wherever possible. Agriculture reform, especially the creation of the household responsibility system, proved to be a solution for rural problems because decentralisation and marketisation were acceptable within one sector of the whole economy due to its relative technical independence which resulted from its lesser development. At the same time reform related to foreign business was an example of decentralisation and marketisation by regions; and this proved workable because of unbalanced development in a huge country like China. But, as far as the reforming effort in the state-owned enterprises, the key part of China’s centralised planning economy, was concerned, nothing comparable in depth and width had been proposed at this stage. However, it soon made its appearance.

4.1.4 Non-state sector: the boom in the private economy

Private economy was a very new term to Chinese students of economics in the late 1970s like myself, because we were taught that all property in the country is state-owned in the name of the people and that only in capitalist state was there a private business which was undoubtedly related to exploitation of the working class by capitalists. Private business was also so negligible that no non-state sector could be discussed. However, small scale individual commercial undertakings did survive the socialist transformation in 1956 though the number was reduced dramatically. For instance, in 1957 there were 3,590,000 individual commercial firms (such as shops, restaurants and repair shops etc.), whereas in 1978 there were only 610,000 (Solinger, 1984). What was more significant was that private business, no matter how small, was condemned as of capitalist nature and the individuals engaged in it were treated as of a very low social class. As one Shanghai trademan put it, "the individual peddler is the worst off person in the new society." (Solinger, 1984).

Collective undertakings remained only in its name since they were put totally under central planning control together with the state-owned enterprises. There was virtually no difference between the two types of ownerships in the 1970s.

The policy change in the non-state sector in the reform period dramatically changed the situation in the country. A rapid expansion occurred in the number of privately owned and operated enterprises in China's major cities. This led to increased job opportunities for unemployed urban residents and an improvement in the provision of scarce urban services. But important as this was, the new enterprises remained, at least on paper, limited in scope. They were allowed to hire only five

employees or apprentices from outside the employer's family and were restricted to such sectors of the economy as catering, services, and handicrafts (Harding, 1987).

Anyhow, the private economy mushroomed. It was important at the margins. In 1985, for example, nearly half of the increase in national retail sales was accounted for by the private sector. By 1986, the state-owned enterprises produced only 68.7% of the total industrial output while in 1976, the figure had been 80.8% (Harding, 1987).

The boom in the non-state sector was also found in the rapid growth of the township and rural enterprises, which not only contributed to domestic economic growth but also became very active in foreign trade. In fact, in 1984-85, township and rural enterprises made 4.5% of China's total export earnings. By 1990, this figure had become 20.8% (Zweig, 1991).

4.2 Comprehensive blueprints of economic reform

It was not until late 1984 that discussions and decisions on the comprehensive reform of the economic system were put on the agenda of the top leadership, even though a number of sectoral reform measures had already been introduced. "The Decision on Economic System Reform by the Central Committee of CCP" in October, 1984, supplemented by a document in 1985 with detailed suggestions on specific issues of reform, indicated a turning-point. In 1987 the 13th Party Congress further confirmed the line of the economic reform (the CCP Document, 1987). It set the tone and principles for a comprehensive reform of the centrally planned system. Furthermore, discussions and suggestions from economists

were also published which enriched the official proposals³. Here, three topics embodied in these discussions are of interest. They are (1) the main features of the prospective economic system, (2) marketisation of the economy, and (3) decentralisation.

4.2.1 The prospective model of the economic system

According to the official proposals, the mainstream of the reformed system was to be a “commodity economy”, which was explained as a planned market economy, if we translate the exact words in Chinese. By that confusing name was meant market-oriented economy with a certain degree of planning control (Kornai, 1992). It left room for the conservatives to argue that a “commodity economy is not necessarily a market economy”. The primary characteristics of the centrally planned economy would remain, while the market mechanism would be active in some areas of activity. The inclination seemed to be towards more market and less planning, although it is very hard to see clearly the division line between them, or the weight to be given to each of them. Despite the rapid growth of private and collective enterprises, the core of the economy remained state owned and operated. With the developing role of market forces, the state played a smaller part in the allocation of goods and services in the economy. But up to the late 1980s, the economy remained highly regulated. The state still issued detailed annual and five-year plans. About 30 to 40 percent of industrial output was subject to mandatory planning, and another 40 percent to 50 percent governed by non-directive plans. Many key prices were set by the government. For instance, interest rates, the prices offered for agricultural output under the contract system,

³ For example, the State Committee for Reform of the Economic System organised research on a mid- and long-term reform plan in which the outstanding economists in the country participated (State Committee for Reform of the Economic System, 1988a). And some economists proposed alternative plans for comprehensive reform (Li, 1989; Wu & Zhou, 1988).

the retail prices for state-distributed agricultural commodities and for industrial commodities produced according to mandatory planning, and the range within which the prices of other industrial products could fluctuate (Harding, 1987).

The status of the state-owned enterprises lay at the heart of reaching the new model of the economic system. The chief aim of the reform was to inject greater flexibility into interaction among the various economic agents, and to give a greater role to market mechanisms in coordinating resource allocation. To this end, reform measures were introduced to reduce the scope of central planning and material allocation by cutting the number of commands sent to enterprises, thus giving them greater autonomy in making production and investment decisions. To make enterprises more cost-conscious in their operations, a variety of profit-retention schemes were introduced, and bank loans increasingly replaced budgetary allocations in financing investment. In 1988, the Law of the State-owned Industrial Enterprise was approved by the People's Congress describing the nature of the reformed state-owned industrial enterprise (Zhu and Fan, 1989). The independence of the enterprise as a producer including hard budget constraint or self-financing, was particularly underlined. A step was even taken towards the destatisation of state-owned enterprises (State Committee for Reform of the Economic System, 1988b). For instance, small shops and services owned by the state were to be sold to private owners. A few medium-sized and even large-sized state-owned industrial and trade undertakings were chosen for the experiment of transforming them into joint-stock companies which could be owned by individuals as well as by organisational shareholders and the state itself. At the stage under discussion, this experiment postulated that only small value shares could be sold to the population and that the state would remain the

major share holder (Section of Enterprise Management, 1988).

As mentioned in section 4.1, non-state ownership was encouraged to develop, including private business both in rural and urban areas. The structure of ownership in the reformed economy was supposed to be multiple with a predominance of state ownership (CCP documents, 1987).

The two most outstanding characteristics of the reform blueprints were the inter-related intentions to decentralise its administration and to marketise its operation.

4.2.2 Decentralisation

With a drive towards marketising the economy, the decentralisation of decision-making was unavoidable. The reform proposals stated that the role of government agencies in economic management was going to be changed along with the deepening reform of the economic system as a whole (the CCP Document, 1987). Among other things, the central planning committee would focus on mid- and long-term plans, avoiding detailed directive control. Economic institutions for comprehensive management would be strengthened in order to enable them to make reasonable and accurate decisions and regulations on macro-economic issues. Local governments would be given more power to rely on economic regulations. Organisations and institutions working in sectors and branches would shift their attention from daily production supervision to long-term target control and technological improvement.

Decentralisation from the centre down to the local authorities was the major point at this stage in the process in China, compared to what is

discussed later in the Soviet case. So local governments played an important part in further reform⁴. To improve incentives for better local supervision of enterprises in the 1980s the state introduced revenue-sharing schemes that allowed most provinces to retain all or a fixed portion of the profits from local enterprises (Wong, 1985).

However, decentralisation brought its own problems which created a dilemma for the reform. Although control over finances, material allocations, and other forms of economic decision-making was decentralised to a degree unprecedented in the past, only a small proportion of this decentralisation moved according to "economic" principles; the bulk went to increase the resources and freedom of action of local government organisations. As a result, serious problems that already characterised the economic system were perpetuated and in some cases exacerbated. Chief among these have been the phenomenon of excessive and redundant investment and the creation of vested interests which lobby against further changes. Equally important, the surrender by the central government of a significant portion of its revenues left it in a precarious budgetary state, forcing it into reacting to a series of shocks and crises. Unable to dominate events, the government had to scramble repeatedly to "put out fires" and to prevent disastrous outcomes. The resultant instability in its policy significantly impaired its ability to formulate a consistent programme of economic reform (Naughton, 1985). Initially, central leaders envisioned a series of reforms that would gradually move a relatively centralised system toward a partially marketised "mixed" economy. But they found themselves facing a decentralised system in which they must manipulate economic rules and incentives and penalties. In general, this made further reforms more difficult: having already given away the "carrot" of greater local control of resources, planners had to wield the "stick" of greater

⁴ For administrative and economic decentralisation, see Chapter 2, footnote 5.

economic accountability. In the meantime, numerous local interests became accustomed to disposing of a large volume of resources without bearing significant responsibility for their effective use. Ultimately, the central government was put in a position where it might have to reassert control over much of the economic realm, but whether in a manner compatible with further economic reforms remained an open question. There was also general agreement that macroeconomic efficiency remained low and even declined in the reform period, thereby negating any marginal gains in microeconomic efficiency. The chief culprit in poor macroeconomic performance was excessive and inappropriate investment. Despite the government's repeated calls to curtail investment so as to concentrate resources on improved utilisation of existing plant and equipment, investment on fixed assets increased from 66.9 billion yuan in 1978 to 84.6 billion in 1982. All the increase came from local investment, which more than doubled during the period. This investment was financed out of the vastly increased resources that profit-retention and depreciation allowances bestowed on enterprises, along with new funds transferred to local government revenues by fiscal decentralisation (Naughton, 1985).

4.2.3 Marketisation

To introduce market mechanisms into regulating economic activities, the reform proposals called for developing markets for various purposes. The first group was created for consumer goods. As noted before, there were already free markets for foodstuffs both in rural and urban areas where a large number of vegetables, meats and cereals, could be purchased. Under the new reform free or quasi-free markets for some less important or small-value manufactured goods were established in many cities. On the further agenda, consumer markets were to be further developed and

enlarged in their range of business(Zhu & Fan, 1989). In addition, markets for production goods were beginning to emerge gradually as a result of declining state distribution. The introduction of capital and technology markets was also under consideration in consequence of the growth of other types of market. The labour market was not mentioned substantially. However, reform proposals stressed that the necessary mobilisation of the labour force would be promoted, but that control of its distribution of labour was to be loosened(Zhu & Fan, 1989)

The essence of a market mechanism---the market-clearing price---was to be introduced at a slower speed than changes in other parts of the system. Price adjustment was the first step towards price liberation. A dual-price system, i.e., planned price and free price, was the next step. Finally, a three-tier prices formation system⁵ was to be effected instead of fully market-set prices (Wu & Zhao, 1988). Of the three, planned prices would apply to a small number of essential production goods and to a very few consumer goods and services which are regarded as of national importance. The majority of consumer goods and services and some production goods would be priced individually on the basis of flexible prices, with limits set by the appropriate state authority. Free market pricing policy would be exercised on some consumer goods, mainly foodstuffs and agricultural products which were in sufficient supply. At the same time, a revision of the planned prices would take place. Specifically, they were to be adjusted to narrow the gap between them and market prices of goods of similar quality and category. The existing price structure of many goods was that the: planned price was the lowest, free market the highest, and the flexible in the middle. So to revise planned prices was to raise them to a reasonable level(CCP document, 1987).

⁵ It is also called as dual-tier price system in the relevant literature because two mechanisms--planning and market--are involved in setting prices.

4.3 Reform Proposals in 1990s

There were actually two phases of economic reform in the 1990s in China. The events of Tiananmen Square were a heavy blow to the process in terms of both practice and proposals (Chan, 1991). The radical tone set at the 13th Party Congress of CCP was replaced, though not completely, by emphasis on following the socialist road. This was especially true in the immediate afterwards in 1989 and 1990. Reform was declared to be the self-perfection of the socialist economic system based on public ownership. There was practically no fresh proposal under discussion until the middle of 1991, when the CCP Central Committee put forward suggestions for the Ten-year Development Programme and the Eighth Five-Year Plan (Beijing Review, Feb.12-18, 1990). Following that, in late 1991, the State Committee for Reform of the Economic Systems worked out a blueprint for economic reform during the periods of the Eighth Five-Year Plan and the Ten-Year Development Program (Beijing Review, Feb.18-Mar.3, 1991). The appeal for renewed radical reform was not announced until early 1992 initiated in the speech by Deng Xiaoping (People's Daily, Mar.10,1992). The 14th Party Congress, held in October 1992, marked a turning-point for the 1990s. However, there is still no substantial progress on concrete planning for extensive reform. What is available now are the main intentions from 1992. From among these, the prospective model for the new type of economy, marketisation, and opening-up are the focus of our discussion.

4.3.1 Economic reform up to 1991

Planning and market

After 1989, it was repeatedly emphasised in official reform publications that the future economic system in China would be one combining a planned economy with market regulation. Measures of reform would both embody the advantages of the planned development of the national economy and effectively give play to the role of market competition in order to achieve the coordinated growth and expansion. The aim was to establish a unified and open socialist market system with equal competition and overall regulation through planning(Beijing Review, Feb.,12-18, 1990).

The combination of planning and market would be realised through three forms of regulation. On the one hand, mandatory planning of a compulsory nature would remain in position, but the plans would take into account market demand and supply. On the other hand, market forces would be released, under the overall guidance of state plans, to regulate the production of some goods. Between these two means of regulation would be guidance planning, or non-directive planning, which would be binding in the sense that it defined the direction and goal of economic activities but would be executed mainly through economic policies and instruments (Beijing Review, Feb., 18-Mar.,3, 1991).

As far as the role of the government was concerned, it was said that its function as administrator of the state-owned sector would be separated from its function as owner, as would the duties of the governmental administrative departments from those of the enterprises. The institutions for economic management at various levels would be restructured in the course of transforming their functions. For this purpose, direct and indirect regulating means would be imposed with a consequent reduction in central control.

Meanwhile, market forces would be particularly strengthened in pricing. With the exception of some essentials, the production and pricing of the majority of consumer goods would be regulated by market demand. Efforts would also be made to develop monetary, technical, information, labour and other sorts of markets for producers' goods(Beijing Review, Feb.,18-Mar.,3, 1991).

Stock-share companies and State-owned enterprises

It was stressed that the trial of stock-share companies began before 1989 would be carried out continuously in a number of large- and medium-sized enterprises in Shenzhen and Shanghai (China Daily, Nov.23, 1991) It was believed that the share-holding system might be an effective remedy for the ailing state-owned enterprises. As to the forms of share-holding company, there was no detailed architecture. However, the general principle was that once the share-holding system was adopted, the state-owned fixed assets, including production equipment, real estate, reserve funds, depreciation funds, working capital and other investments, would be converted into shares with dividends allocated accordingly. The project on assessing the values of state property in state-owned enterprises was begun(China Daily, Nov., 20, 1991).

Further opening-up

The opening-up policy would be enforced further, it was said, through a series of measures. First of all, more regions were given rights similar to those of the special economic zones. For example, in Shanghai, the largest and most important industrial city in China, a sizable area--Pudong--was given this special status(Beijing Review, Sept.,9-15, 1991). And secondly, laws and decrees on the management of joint ventures using foreign capital

were issued very much in their favour. For instance, an amendment to the Law On Joint Ventures Using Chinese and Foreign Investment revised some key items so that foreign capital would get a greater return on its investment in the country. It was guaranteed that there would be no nationalisation or requisition of joint ventures. And the post of chairman of the board of directors was no longer confined to Chinese as had been required in earlier editions of the Law (Beijing Review, May 7-13, 1990).

4.3.2 Radical reform in 1992

Early in 1992, the new and very radical approach to further economic reform was made public, following the time-consuming struggle between the reformers led by Deng Xiaoping and the conservatives. Deng's south China talks and pronouncements have once again altered the country's outlook and have undoubtedly made a historic contribution to its transformation from a planned economic system to a market economic structure. The general principle for economic reform said little more than that the only goal now is to promote economic development as rapidly as possible by any effective means. The implication is obvious: ideological obstacles should be removed in order to allow the market system to play a full role in the prospective economy, under conditions of individual ownership if necessary. As Deng put it, " we should be bolder than before in conducting reform and opening and have the courage to experiment." (Beijing Review, 1994). And he went on, " those who are unable to move ahead with reform and opening, and who lack the courage to break new ground, are, to put it bluntly, afraid that they would be introducing too many capitalist factors, and therefore taking the capitalist road. The crux of the matter is whether this road is 'capitalist' or 'socialist'. The criterion in making such a distinction should primarily be

whether it promotes the growth of productive forces in a socialist society, whether it enhances the overall national strength of the socialist state and the people's living standards." (Beijing Review, 1994) To be specific, "whether there should be more planning or more market factors is not the essential difference between socialism and capitalism....Both planning and market are economic means. The basic nature of socialism is to emancipate and develop the productive forces, eliminate exploitation, rule out polarisation, and ultimately achieve common prosperity." (Beijing Review, 1994) This was overwhelmingly approved in spirit at the 14th Party Congress of the CCP (People's Daily, Oct., 21, 1992). However, by the end of 1992, an operational blueprint for such extensive restructuring was still a matter of discussion .

Prospective model of the economic system

What the 14th Party Congress produced was a firm attempt to establish a "socialist market economy" (the CCP Document, 1992). Although China's post-Mao leaders are devoted to reform, they also remain committed to socialism. Therein lies a paradox. The principles of economic reform just discussed conflict with a crucial element of the socialist ethic in contemporary China. The spirit of reform calls for an increase in private enterprise, but the socialist ethic demands the predominance of public ownership of the means of production. Reform allows a greater role for market forces in the economy, but the socialist ethic insists on the continued primacy of state planning. And reformism emphasises the use of material incentives to stimulate production, but socialism warns against a polarisation of rich and poor and extols the spirit of "plain living and hard struggle". This tension between the reformist spirit and the socialist ethic has been at the centre of the debate over economic reform that has continued throughout the post-Mao era. The moderate reformers have

given high priority to maintaining an economic system that embodies traditional socialist values, whereas the radical reformers have been more willing to accept a greater degree of private ownership, market mechanisms, and even economic inequality.

It was stressed in Jiang Zeming's speech at the 14th Party Congress that the "socialist market economy" differed from the planned market economy proposed by the 13th Party Congress in 1987, not only in terminology but also in essence. By socialist market economy was meant letting market forces, under the macro-economic control of the state, serve as the basic means of regulating the allocation of resources so as to subject economic activity to the law of value and to make it responsive to the changing relations between supply and demand. "The socialist market economy is a component part of the basic system of socialism. So far as the ownership structure is concerned, for a long time to come we should allow diverse sectors of the economy to develop side by side. The public sector...is to remain predominant, with the private sector...as a supplement." (CCP Document, 1992).

Specifically, planning control will continue at the macro-economic level but it will be substantially reduced in scope. The market mechanism will be fully operative in the majority of economic activities. In particular, it will be introduced into allocating economic resources and coordinating the economy as a whole. However, in the future Chinese model public ownership, i.e., state ownership, will be the predominant type in various areas. For instance, the existing state-owned enterprises may be transformed into joint stock companies, but the state will be the main share-holder. This will particularly apply to the medium and large-sized undertakings. Public ownership in this sense will signify the socialist

nature of the so-called socialist market economy (the CCP Document, 1992).

Planning control

Direct planning control, it is said, will be confined to a few items of national importance. Indirect planning control, i.e., guidance planning and economic instruments such as taxation, interest rates and the like.⁶, will play a major part in managing the whole economy (People's Daily, Sept., 24, 1992). A state order system at planned prices will replace state procurement for some production goods, while the majority of commodities will find their own prices on the free market (People's Daily, Sept., 25, 1992).

Marketisation

In the new round of economic reform, the market mechanism will be particularly active in the price formation of production goods. The three-tier system will gradually be eliminated through reducing state-set and increasing market-set prices. The number of production goods whose prices are set by the state was to be reduced from 737 in 1991 to 89 in 1992 (People's Daily, Sept., 2, 1992). This means that about 600 were to be priced primarily by market forces⁷. Of the 89 products, state guidance prices⁸ were to apply to 55 and only 34 were to be directly priced by the state agency.

The establishment of a wholesale market, a production goods market and capital and labour markets are mentioned repeatedly in the new reform proposals (People's Daily, Sept., 11, 1992). And in this connection it is

⁶ See Chapter 2, 2.2.2, instrument focus.

⁷ Of these, the prices of 571 were to be set at the level of enterprises, and 22 at the level of local authorities (People's Daily, Sept., 2, 1992).

⁸ That is, the state only sets the ceiling or bottom limit. See section 4.2.2.

significant that the stock market has grown markedly during the 1990s in some important cities like Shanghai and Shenzhen.

Before ending this section, two further points about opening-up and private economy should be mentioned. Following the opening-up of the country's coastal regions, the inland area became the next focus of attention. The Capital cities of the North-West Provinces⁹ were given similar privileges in the autumn of 1992 (People's Daily, Sept.,3, 1992). Thus, there were altogether about 300 cities in China opened up to foreign business(People's Daily, Oct.,8, 1992). This shows a strong determination to integrate the domestic economy with the international market.

The private economy also continued to grow in the 1990s. In 1992 the private sector produced a total of 113 billion yuan in gross output. By the end of the year there were 15.3 million individual industrial and commercial units throughout the country, with 24.6 million employees. (Beijing Review, 1993)

So the Chinese economy is moving toward a mixed economy. In 1992 government mandatory planning extended to only 10% of industrial production, whereas before 1992 the figure was 40%. Only 10% of retail sales commodity prices were set by the state. Market prices applied to 70% of all industrial materials and 70% of agricultural products. (Beijing Review, 1993)

4.4 Approaching to a New Economic System

The purpose of this section is to review and summarise the proposals of economic reform in China in the decade from the late 1970s to the 1990s in

⁹ Shaanxi, Gansu, Xinjiang, Ningxia and Qinghai.

the language of the theoretical assumptions set out in our analytical framework. The question here is where has China got to, on paper, in reforming its centrally planned economy, measured by the ruler established in this dissertation. As pointed out above, the tones and plans of the reform in the period of about 14 years were not uniform. So the relative importance of the various stages are given special attention where necessary. Two aspects in particular are under discussion: (1) partial or complete change in the basic elements of the economic system; and (2) systemic features of the Chinese-type economy:.

4.4.1 Changed structures

Have the basic structures of the economic system been altered by the reform proposals? To answer this, the most important aspects of four systemic structures are surveyed in the light of our theoretical framework

Decision-making power. Two aspects of decision-making power need to be examined in order to see the direction and depth of China's economic reform. First is its location. Decentralisation has always been the principal direction of any economic reform in a centrally planned economy due to the very fact of excessive centralisation. However, as Morris Bornstein classified it (Bornstein, 1977), administrative decentralisation and economic decentralisation refer to different magnitudes of reform. In China's reform proposals, both economic and administrative decentralisation are given important positions, but the former constitutes an essential component in the late stages. Decentralisation of decision-making in agricultural production could be said to have gone as far towards the limit as is possible in a centrally planned economy at the stage, when the household responsibility system and other supplementary

measures were legalised and became the overwhelming mode. It is not inaccurate to conclude, therefore, that the post-reform decision-making structure in Chinese agriculture is, to a large extent, that of a regulated market economy with minimum intervention by the State. This is because, apart from the change in the degree of concentration of making decisions, the means of the state's executing decisions in this sector is modified as well. Commanding from the centre will not now work effectively, and the state will seldom be able to poke its nose directly into interfering with farmers' actions, except by decreasing its purchases within contracts. Such regulation as it will have over agricultural production will be by economic means, e.g. by the purchasing prices it pays.

However, the economic system as a whole has not been changed as greatly as in the case of the rural sector. It was administrative decentralisation to the local authorities that was the major first step in the reform process. Even the decentralisation process in the special regions for foreign business is more or less limited to the administrative issues. In the special economic zones, where the most advanced areas in terms of marketised economy are located, local government still retains critical power to make key decisions, and planning control in its broad sense is actively employed on many occasions. In the state-owned enterprises reform attempts are by way of economic decentralisation through endorsing more autonomous rights to managements to conduct their daily business. The aim of transforming these enterprises into independent producers through a responsibility system and joint stock companies was specified in the reform proposals and subsequently legalised. But it was stressed that state ownership would remain.

Looking over the economy as a whole, the decentralisation tendency, both

administrative and economic , has been accelerating extensively. The decentralisation of decision-making power to local authorities is particularly impressive. But mandatory instructions still stand as the main tool for authorities at any level to get the relevant decisions implemented.

Information structure. It is obvious that the important information structure has been changed with the steps towards decentralising and marketising the existing economy. For example, information travels more and more in a horizontal rather than a vertical direction,, with the loosening of planning control from the centre. Much of the information takes the form of prices and quantities instead of instructions, qualitative requirements and so on.

As far as the co-ordination mechanisms in the economy are concerned, the market plays an increasing role, taking the place of the planning tool. In the important sectors of agriculture and foreign trade, market forces take a predominant position among regulating instruments. From the point of view of consumption, markets are working efficiently. In the production of state-owned enterprises market signals are taken account of in decision-making and other respects. Nevertheless, the whole economy is coordinated partly by planning, partly by market, depending on the individual case. The administrative mechanism in this field plays a decisive role because the growth of market forces is constrained by the planners no matter whether they are reformers or not. This is, unfortunately, the typical case; or to put it another way, this is the only choice possible in the course of transforming the centrally planned economy into any kind of market-oriented economy.

Motivation structure. One of the most impressive features of progress in

China's economic reform lies in its success in motivating individual participants in the economy by focusing on new incentives. In a society unified by values like solidarity, non-material motivation used to underlie all individual economic activities, apart of course from the traditional incentives of central planning controls. The reform proposals have paid increasing attention to material incentives as the principal way to realise the intentions of the state and to meet the wishes of the population. Individual interests deviating from those of the planners are no longer denied and neglected, but are encouraged to develop through the growth in private business. The different goals and aims of the various agents in the economic system, i.e. the state, the planners, the producers and the consumers, are taken into consideration when necessary.

Ownership structure. Issues of ownership have been dealt with only slightly and with great caution in the reform proposals. State-ownership, or non-individual ownership, is declared to be the predominant category in the post-reform situation, especially in the non-agricultural sectors which constitute such a vital part of China's economic capacity. In the rural areas, the long-term leasing of land to individual households should be regarded as a sort of individual ownership, even if it is still called collective ownership. Individual ownership can also be found in the small sector of private business and in part of the state-owned sector where some of the small scale enterprises and shops have been sold or let to individuals. The responsibility system in industrial production does not change the nature of ownership in the state-owned enterprises. At most it is experimenting with the separation of the influence of ownership from the outcome of the technical management of production, since some of the defects of the state-owned enterprises are attributed to managerial shortcomings. Shareholding companies are designed at the moment to be primarily collective

or non-individual owned since the state or institutions will hold a large proportion of the stocks. Of course, individuals are allowed to purchase shares, but this category of share-holders will not be significantly large in the near future.

4.4.2 The Chinese-type economy: systemic features

According to their proposals, the reformers in China are attempting to transform the existing centralised planning economy into a so-called socialist market economy with Chinese characteristics. Unfortunately, there is still no definitive description of what exactly this will be, but only a general and vague one, which makes any conclusion difficult. To help, we may review the reformers' ideas about the major features of the economic system by looking at stages in the normal transition process from a centrally planned economy to a market economy. Then, by locating the Chinese-type economy at its appropriate position, its systemic characteristics can be shown in a more or less clear way.

How then do the Chinese reformers think about transforming the old to the new Chinese-type economy--the socialist market economy? Based on the discussions in this chapter, it is possible to choose some points that represent the main features of the system in operation during the course of transition. To the architects of China's economic reform, there are certain stages that will be experienced by reform on the road to its destination.(see Panel 4-4-2).

It is not the subject of our discussion to determine whether or not the combination of the changes at each stage between the poles of planning and market is possible in theory and in practice, and whether or not each stage

is a static expression of an economic system. What we are concerned with here is to identify a certain position anticipated for the Chinese-type economy by those who are reforming it. To the present author, Stage 4 is that position. It would be, in a few words, a market-oriented economy under the very strong shadow of state intervention because of the existence of substantial state-owned industrial undertakings.

Panel 4-4-2 Major Stages of Transforming Planning Economy In China

	<u>Planning Control</u>	<u>Market forces</u>
Stage 1	P-	M ₀
Stage 2	P- -	M+
Stage 3	P---	M++
Stage 4	P----	M+++

Notes:

P-: loosening planning control in a very limited sense and to some small sectors or branches considered as exceptions, for example, reducing planning orders for agricultural production;

P--: reducing the extent of planning control for a whole sector in the economy and for a certain share of the production of the state-owned non-industrial enterprises not controlled directly by the state plan, for instance, no state planning for agricultural production;

P---: central planning agencies no longer involved in short-term plan formation but only in long-term development programmes, the means of planning control less significant for the whole economy than economic instruments such as credit and finance;

P----: no specific direct planning but only broad indirective planning, state intervention existing but not playing the commanding role in the economy;

M₀: market forces not to be found in important sectors of the economy;

M₊: some elements of market forces introduced into some parts of the economy which do not influence the existing way of operation of the economic system, for example, small-sized free markets for some food goods;

M₊₊: at least half of the economic activities working in accordance with market forces, and markets for a majority of consumer goods and some producer goods;

M₊₊₊: full-blooded market mechanisms apply, and a set of markets established.

Chapter 5: Reforming Proposals In The Soviet Economy, 1985--1991

M.S.Gorbachev was history together with the USSR. It is inaccurate to say that the radical reform of the Soviet-type economic system in the Soviet Union started under M.S. Gorbachev's era. It is true, however, to say that it was Gorbachev who had made it possible and feasible for the most fundamental change in this field in the Soviet history. *Uskorenie*, *glasnost'* and *perestroika* were put forward bringing hope to revitalise the Soviet society (Battle,1988). Among the major objectives of Gorbachev's leadership, economic restructuring stood out as the most crucial strategy for approaching a satisfactory society (Hewett, 1985).

During the period of 1985-1991, the Soviet economy and society had experienced the most crucial time in its history. As far as the economic reform was concerned, discussions on the relevant issues of the reform had been the hot topic in the country ever since the mid-1980s. Surveying the course of economic reform in terms of substantial proposals, three phases of the reform could be discerned up to the end of 1991 when the country finally saw its end as a political entity. The packages of proposals and plans are those published during the periods of 1985-1987/88(Phase 1), 1989-1990(Phase 2), and 1991(Phase 3).

The economic reform in the former Soviet Union was launched immediately after Gorbachev assumed his post in 1985(Current Digest, 1991b). However, a systematic official proposal for economic reform had not been put forward until 1987. In June 1987, a package of measures for altering the operation of economic mechanisms in the Soviet economy was approved as a decree by the Supreme Soviet. The full title of it was " The Basic Provisions for Fundamentally Reorganising Economic Management" (Aslund, 1991). Following the general principle, there were other supplementary decrees adopted

officially, e.g. ten decrees involving planning, the management of scientific-technical progress, material supplies, financial mechanisms, price formation, banking, statistics, branch ministries, republican organs, and social policy etc. Moreover, a new law on the state-owned enterprises (associations) also constituted a key part of the reform measures in 1987. For conventional purposes we shall call those measures as a whole the reform package of 1987. By this title it does not limit the contents of the package to the proposals adopted in 1987 only. Some elements of the measures put forward in earlier years, for instance, in 1986, were included, because the process of reforming the economic system had been continuous. In one word, the reform package of 1987 defined above would be regarded as the official document on economic reform in the Soviet Union up to 1990 when the further design publicly began.

1990, or to be exact, 1989 and 1990, saw at least over ten plans for reforming the Soviet economy in a more radical way than the package of 1987 (Financial Times, Nov.5, 1991). Of them three were officially organised and worked out. They were, (1) the Ryzhkov government programme which was based on the "Albalkin Blueprint" (October, 1989) and presented in September, 1990 (Current Digest, 1990b); (2) Shatalin's 500-day plan formed in August, 1990 (Current Digest, 1990e); and (3) the Presidential plan published in October, 1990 (Current Digest, 1990f). There was argument and discussion around these three major packages for economic reform in the country. The problem of economic reform, as Aslund put it, was not whether it would go toward a market economy but how (Aslund, 1991). The Ryzhkov government plan designated a moderate-radical reform which aimed at establishing a regulated market economy in the Soviet Union, while Shatalin's 500-day plan called for radical transformation of the economy into a genuine market economy with substantial private ownership. It was commonly agreed that the Presidential plan, entitled "the Basic

Guidelines for Stabilisation of the National Economy and Transition to a Market Economy” (*Izvestia*, 1990), was the result of compromise between the radical Shatalin’s plan and the moderate Ryzhkov government programme. It was accepted as the operational blueprint for economic reform in the Soviet Union at that time (*Current Digest*, 1990d). The consensus on the major issues of the economic reform between the Shatalin plan and the Presidential plan would be of interest in this thesis.

Entering the 1990s, the political situation deteriorated. Economic reform at all-Union level stood still against a background of a disintegrating the USSR and political struggles centring around Gorbachev (*Lapidus*, 1990/91). Anyhow, pieces of plans were published from the central government about economic reform, privatisation and price reform in particular. But the most influential ones were put forward by the Russian republic itself (*Tedstrom*, 1991c; *Bush*, 1991), based on the essence of the Shatalin's 500-day plan.

The structure of this chapter was arranged according to the Soviet case, though the analysis pattern applied in Chapter Four was followed. There should be no reason against the decision that for the purpose of this thesis the 1987 package of reform and the plans in 1990 must become the major subject for analysing and discussing reform proposals in the Soviet Union during Gorbachev’s era. Two sections of this chapter therefore focused individually on the two packages of reform proposals. The major points of concern included proposed changes to the role of central planning, marketisation, status of state-owned enterprises and foreign economic activity. In Section Three where the introduction of reform proposals after 1990 was dealt with, Russian reform programme was one of the major topics when there was actually no substantial suggestion for economic reform at an all-Union level. A summary part of the discussion was the final section, i.e, Section Four,

where the mainstream of economic system transformation in the Soviet Union up to 1991 was summarised in terms of economic system theory. And the major features of the prospective model of economic system designated were analysed in the framework of existing classification of various economic systems.

5.1 The economic reform package of 1987

The 1987 package for restructuring economic mechanisms covered a wide range of issues in the Soviet economy. Almost all the main aspects of the operation of the system had been mentioned and dealt with. It involved, for instance, the role of central planning, the status of the state-owned enterprises, the role of central and regional administrative bodies, the supply system, prices and wages, finance and credit, foreign trade and external economy, private and cooperative economic activity, agricultural reform and so on (Schroeder, 1987). Constrained by space, we could only concentrate on some of them. The important areas of concern here were the intended changes on, (1) the central planning control; (2) state-owned enterprises; (3) market forces relating to price formation and allocation of investment; (4) private and cooperative business and others. Detailed discussions on these issues should enable one to reveal the characteristics of the nature of economic reform in the Soviet Union.

5.1.1 Central Planning Control

Central planning control, or to use its another name, administrative control, was the core of the centrally planned system. The 1987 reform package stated that the general planning control by the centre over the national economy would be retained. The Soviet economy would continue being planned and managed as “a unified national economic complex”(Schroeder, 1987). The state intended to determine the

directions of economic development and enforce programmes of scientific-technical progress that were worked out from the top. The system of state orders to state-owned enterprises, i.e, the plan directives, would be retained, and through it the government would continue to dictate production and allocate the requisite materials for the part of output produced for state orders. What was noticeable was that the share of the state orders in total output was supposed to decrease gradually.

The change to central planning control was said to be on its focus and the means of control. Only the most important variables of national importance would be under consideration of the central planning committee, while all operational decisions were left to lower levels (Aslund, 1991). This would be realised by working out the basic economic policies and specific targets for a long-term plan, i.e. 15 years, at the top, namely, by Gosplan. The formation of the operational plans---five-year and annual plans---would be done at republican and ministerial level and even down to the enterprises' level on the condition that in those plans the policies and goals set by the centre must be followed and embodied. The centre would retain the power to supervise and approve the operational plans. However, planners would principally use economic instruments to guide economic activity, avoiding direct commands to individual enterprises as happened before the reform. As a result, the enterprises would receive from the planning authority the following orders (Schroeder, 1987): (a) non-obligatory control figures that specified value of output, profit, foreign currency receipts, and major indicators of scientific and technological progress and social development; (b) a mandatory bill of state orders for output that "ensure meeting society's priority needs"; (c) limits, which include rationed goods and centralised investment allocations; (d) long-term economic normatives based on a list approved by the Council of Ministers regulating, among other things, growth of total wages,

payments for capital and labour, and the allocation of profits among various kinds of taxes and reserve funds set up by ministries and enterprises. The three major funds were the bonus fund, the social development fund, and the fund for financing research and development and investment.

5.1.2 State-owned Enterprises

With the loosening of central planning control, the status of state-owned enterprises was declared to be altered. The new Law on the State Enterprises (Associations) defined the features of the state-owned enterprises as, (a) firms founded and liquidated by superior authorities; (b) accorded legal rights of possessions, use, and disposal of physical assets under state ownership; and (c) formally subordinate to government agencies--ministries or regional institutions (Aslund, 1991)

What was significant in terms of economic reform lied in the part of the Law relating to the decision making power of the enterprises. Specifically speaking, the firm "was entitled to make on its own initiative any decisions provided that they do not run counter to existing legislation". For instance, it was able to work out and approve its 5-year and annual plans of higher authority, on the condition listed at the end of the previous section. And the firm should also base its plans on the demands of its customers, which would result in the contracts between the firm and its customers. Under the new Law, the enterprise was endowed practical autonomous rights referring to setting output and input mix of its production; choosing its customers and suppliers; deciding on the structure of wages and bonuses and magnitude of capital investments. Nevertheless, the firm was required to be responsible for financing its current and capital expenditures from its sales revenues and other internally generated funds. This meant that the enterprise must be able to produce salable goods and, to a large extent, run its

business on its own. This was called the “full economic accountability and self-finance” (Schroeder, 1987). The implication of self-financing indicated the inclination towards altering the soft budget constraints on enterprise, though the reform intention of the new Law was a far from efficient measure for coping with the problem.

One should not overestimate the depth of the reform proposal in the new Law on State Enterprises if one examined the statement on the major issues. For example, with the new Law, the four categories of plan indicators were retained. The enterprise was obliged to obey plan discipline and fulfil the plan orders and contracts, which would be considered as the most important criterion for evaluating the performance of the enterprise and rewarding it. Here one could see the 1987 reform proposal full of contradictions for what it intended to change and to retain. On some issues the reformers designated a radical transformation. At the same time they showed a conservative attitude towards the related issues. For instance, full economic accountability and self-financing of the state-owned enterprises was emphasised in the reform plan. But the same plan kept a system of state order remained. As long as planned control determined the production of the enterprise, how could one expect it to be self-financed in the real sense?¹

The most radical elements of the new Law concerned the internal management of enterprise. Self-management in enterprise was adopted by the Law. There shall be, as it said, a Labour Council elected by all members of the firm. The election of key managerial personnel would be done in the same way. The Council was given powers on deciding a variety of matters relating to the use of the enterprise incentive funds and to the pay, discipline, and training of the workforce. The selection of the managers, which would be carried out at intervals of every 5-

¹ The author agreed with Alec Nove when he pointed out in a personal talk with the author that as long as there was any plan directive for enterprise, no matter how few it was, it was impossible for the enterprise to be self-financed.

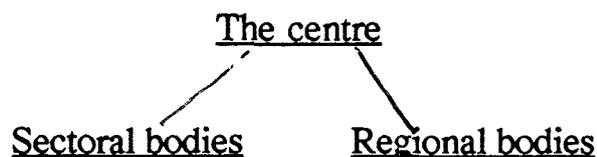
year, must be ratified by the proper superior authorities. Managers might be removed by vote of the collective, i.e, all members of the enterprise(Aslund, 1991).

There was one further radical point that should be noticed in the new Law. It provided the possibility for declaring bankrupt and liquidating firms that persistently made losses(Aslund, 1991). However, there was no detailed measure for implementing this procedure.

5.1.3 Redivision of decision-making power

Administrative decentralisation constituted a major part of the 1987 reform package. Much attention was paid to dividing the decision-making power between the centre and lower echelons, between central agencies and sectoral institutions. The functions, roles and sizes of bureaucracies at both higher and lower echelons were said to be revised.

The structure of administrative organisation in the Soviet economy can be drawn roughly like two branches of a tree:



Under this structure, restructuring the decision-making power went in two ways. On the one hand, by redefining the functions of the central organisations and sectoral organisations (ministries) it was moving towards recentralisation. On the other hand, decentralisation in perspective of ministerial bureaucracies was on its way.

First of all, the existing all-Union committees such as Gosplan, Gosnap,

the State Committee for Science and Technology, would be reorganised in order to allow them change their working foci from detailed management to longer-term strategy of the national economic planning and development (Schroeder, 1987). In particular, Gosplan was to play a key role in coordinating the work of all central bodies dealing with economic issues, to work out five-year and fifteen-year plans, and to determine the composition of state orders and other related jobs.

Furthermore, some new bodies were created at the level of superministries², which were subordinate directly to the USSR Council of Ministries. The purpose for such a sort of recentralisation was said to reinforce the centre in planning the strategic development of the relevant branches, and to carry out a radical reform of economic management.

As to the ministries, a certain part of them, namely, sectoral subbranches, would be replaced by the establishment of 'several thousands' large associations, including interbranch state associations, concerns and state associations, and enterprises under the direct control of the ministries (Johnson and Kroll, 1991). As a result, the function of the ministry in the management of the economy would have been changed. It would act as an intermediate link in planning and the administrative process, in lieu of the day-to-day management of numerous firms. It was supposed to play the role of a general supervisor who was responsible for principal issues relating to the activities of the association and enterprises subordinate to it (Aslund, 1991).

On the side of decision-making power division between the central and regional bodies, the reform process was in line with one-way

² Such as the State Foreign-Economic Commission, the State Agro-Industrial Commission and so on (Aslund, 1991).

decentralisation. By the “basic Provision” of the 1987 reform package, the republican councils of ministers and their inferior organs, notably the local soviets, were accorded a greater role and responsibility for regional economies. The decision-making powers of republican and local governments would be strengthened (Schroeder, 1987).

In summary, the 1987 reform package stepped further in the direction of redividing the administrative responsibility in structure of bureaucracy, both recentralisation and decentralisation to and from the centre.

5.1.4 Market forces in pricing and investment allocation

In discussion of introducing market forces or mechanisms by the 1987 reform package, only some aspects of the issue are briefly covered here. They refer to the price formation and the means of allocating investment including production materials.

The 1987 reform package called for, in principle, a radical reform on the pricing system. This reform encompassed all categories of prices, e.g. wholesale, procurement, and retail prices and rates. Attention was paid to interrelating the changes in the various sets of prices(Bornstein, 1987).

Prices revision was taken as the preparatory step for reforming the mechanism of price formation. Prices of certain goods would be revised according to their market demand prices. For example, there would be a substantial increase in the price of fuels and raw materials relative to that of manufactured goods(Schroeder, 1987).

Although the reform tone was high, market forces in setting prices would, by and large, not be strong if the 1987 reform package could be

carried out. In the reformed pricing system prices would be formed by more than one formula (Hewett, 1988). A few products of national importance, such as raw materials, fuels, scarce goods etc. would take the form of state-set price, or as called, planned price. The share of this kind of price would be reduced greatly. In determining state-set price, several factors would be taken into account. It consisted of "socially necessary expenses of production and sale, utility, quality, and effective demand." (Schroeder, 1987). Specifically, they included the charges for natural resources, capital, any labour, and the costs of environmental protection. For the bulk of remaining products, the contract price would be applied. It was the price negotiated between buyer and seller, following rules established by Goskomtsen on the same basic principle as state-set prices. The real market price was not mentioned yet in the 1987 reform package, while the sensitive issue of revising retail prices to conform to the new pricing formula was avoided as well. The statement that changes in retail prices "not only must not reduce living standards of workers, but also must raise them for some groups and more fully promote social justice," implied the concern and reluctance of radically reforming the price setting mechanism (Aslund, 1991).

Like some of the past reform designs, the 1987 reform package intended to take effective use of bank credits and interests to serve as important economic levers in promoting efficient resource use (Patrakov, 1987). And bank credits were to become a more important source of financing investment. Together with self-financing of the enterprises, the function of banks was emphasised. The banking organisations would be correspondingly enlarged (Schroeder, 1987).

Changes in allocating investment consisted of the change of supply system of production goods. In this respect, wholesale trade of producers' goods would substitute, to a large extent, the centralised and administrative ration for the main channel of supply (Hewett, 1988).

However, it was Gosnab that would be in charge of organising wholesale trade. The inputs required for production of state orders would remain being rationed with some other “particularly scarce” goods.

In summary, some kinds of market forces would be introduced in the new pricing system and the mechanism in allocating investment resources. But there was no detailed measures for implementing these sorts of changes.

5.1.5 Other issues

Under this subheading, other essential aspects of the Soviet economy that would be reformed by the 1987 reform package beside those mentioned above were to be discussed briefly. They comprised agricultural reform, new policy for cooperative and private business, and external economy.

In the Soviet economy, agricultural production had been more of a problem. It was, therefore, not surprising that reform in this sector started earlier than the overall reform. Some measures had been put forward as early as 1985, when the first decree on agricultural reform was adopted officially (Aslund, 1991). The main tone for improving agricultural production sounded like its counterpart in the initial stage of rural reform in China, i.e. increasing the autonomy of farms and stressing the material incentives. According to the reform decree, farms were allowed to sell a larger share of products at market prices. Measures to market farm products more flexibly were introduced, and many of the arrangements, similar to those applying to industrial enterprises, would be exercised by farms. Moreover, collective contracts were widely used (Comparative Economic Studies, 1990).

The 1987 reform package did not refer very much to agricultural reform, though in a general way it did. However, the issue still stood out as important. Collective contracts and full economic accountability and self-financing brigades, family groups in particular, using intensive technology were strongly endorsed by Gorbachev and CPSU (Comparative Economic Studies, 1990).

The second issue of concern referred to the private and cooperative entities in the Soviet economy. In the years 1986 and 1987, documents on permitting and extending private business and cooperatives were adopted (Aslund, 1991). The role of cooperative and private business in the Soviet economy had been confirmed, though confined to the provision of consumer goods and services in small size. This was a minor but breakthrough step forward towards radical reform in a centrally planned economy like the Soviet Union in the field of ownership structure. The Law on the State Enterprise held that cooperatives could be established under a state enterprise³. The Law on Cooperatives stipulated that cooperatives, unlike state enterprises, would not be subject to compulsory plan assignments; it could be granted substantial freedom to set wages and prices. However, the cooperatives would also be not able to get supply from the Gosnap, which would largely determine the fate of this sort of undertakings. That is, they would not play a significant part in the economy.

Last but not least, in 1987, there was an important step taken in promoting external economic activity in the USSR. The decree of the USSR Council of Ministers on the Establishment in the Territory of the USSR and Operation of Joint Ventures with the Participations of Soviet Organisations and Firms from Capitalist and Developing Countries was published in January which marked a breakthrough in this sphere

³ The development of this kind of cooperatives which took about 80 percent of cooperative business in the former Soviet Union is discussed in relevant Soviet press (Current Digest, 1991d).

(Tiusanen, 1990). This, together with other supplementary decrees, set the legal framework for development of the external economy of the USSR.

5.2 Radicalisation of economic reform: the 1990 plans

Although only about two or three years later than the 1987 reform package, the 1990 reform plans set an almost entirely different tone for radically transforming the planned economy in the Soviet Union. Switching to a market economy, accompanied by destatisation of ownership of property, became the mainstream of the reform, the first ever in the history of the Soviet economy. For reason of convention, the 1990 reform plans here are defined as a summary and consensus of the main points of the reform proposals in the Presidential plan and Shatalin's plan, with the former plan carrying more weight in the discussion. The range of the reform plans were fairly wide covering a number of major issues in the economy. For example, they referred to property ownership in general, ownership and disposition of land, operating rules for all enterprises regardless of ownership, measures to promote small businesses, prevention of monopoly, and demonopolisation, establishment of a western-style central bank and a two-tier commercial banking system, creation of a securities market, general conditions for investment and employment, and foreign trade etc. While the general reform proposals, including the Presidential plan, were rich in putting forward the general line for the changes on a number of important areas, unfortunately, only some of the changes could be dealt with here. They are, (1) marketising the centrally planned economy; (2) destatisation and privatisation of the state-owned business; (3) price formation; (4) other issues of opening-up the Soviet economy and land reform.

5.2.1 Marketising the planned economy

As it stated, “ there was no alternative to switching to a market” and this choice “has been made a choice of historic importance to the fate of the country” (Schroeder, 1991), the Presidential plan was going to radicalise the reform process through marketisation of the planned economy. Calling for transforming the Soviet economy to a genuine market economy in principle, it was to establish a single market in the entire country. Correspondingly, central bank and a “reserve system” would be the case in the new market economy (Current Digest, 1990f).⁴ Most prices would be determined by supply and demand of the market, but this procedure would go gradually in the Presidential plan and faster by Shatalin’s plan. Enterprises would become independent and operate primarily in a market environment. The Ruble would be convertible internally first and then externally at the end of the reform⁵.

A market economy was thought of as the only way for the Soviet Union to achieve the dynamic development of the national economy, a suitable standard of well-being for the population. As Gorbachev himself put it, “economic freedom, the economic independence of production collectives and individuals, presupposes many forms of interaction using rules and mechanisms of exchange and distribution. All this was possible within the framework of the market.” (Tedstrom, 1990).

In the course of the reform, (it would take two or more years according to the implementing schedule of the Presidential plan,) the comprehensive central planning would be eliminated gradually with the state order system being retained in order to gain stability of the economy in the early stages of the reform process. A new body called the Union Contractual System would take the place of the central

⁴ This was one of the issues that Presidential plan disputed with Shatalin’s plan because the latter designed a looser economic tie between the republics(Current Digest, 1990e)

⁵ Internally convertible ruble means Soviet citizens and undertakings can take part in daily-foreign currency exchange with ruble.

planning agency to issue state orders to enterprises, and the magnitude of the orders would keep declining (Hewett, 1990/91).

Switching to a market economy in the 1990 reform plans was taken more or less as a critical political decision because there was no detailed and practical measures proposed to implement the process. However, institutions would be established to allow further development in the short future of a genuine and efficient set of market mechanisms so that a market economy would be shaped in the Soviet Union (Hewett, 1990/91).

5.2.2 Destatisation and privatisation

The core feature and the most noticeable content of the 1990 reform plans was the appeal and device for fundamentally transforming state ownership in the Soviet economy. Destatisation and privatisation were proposed to achieve this aim by both the presidential plan and Shatalin's plan.

Destatisation (*razgosudarstvlenie*), according to the definition of its architects, meant a process of taking the assets out of the hand of the state, or bureaucrats, whilst it does not necessarily imply selling or giving those assets to individual persons. The latter was defined as privatisation process (Hewett, 1990/91).

According to the architects of property reform, ownership was classified in the law as citizens' ownership (individual ownership), collective ownership, and state ownership. The course of destatisation and privatisation would be unfolded by steps, depending on the importance of the state-owned assets in the national economy. Leasing was the ready measure for the starting of the process of transition of property rights from state to other owners (Johnson & Kroll, 1991) In

some cases, the transfer to leasing status had been an intermediate step in the conversion of state enterprises to collectively owned enterprises through employee buyouts. As far as certain categories of state assets and small business were concerned, a quick sell-off and straightforward privatisation would be carried out (Current Digest, 1990f). By certain categories of state assets it referred to a portion of the state-held fleet of autos and trucks, unfinished construction projects, uninstalled equipment and construction materials, various civilian products now in the hands of the military, and assets held by "social organisations" and other party organisations supported with state funds (Hewett, 1990/91).

The the majority of large enterprises would be transferred from the hands of the state to state-holding companies first. And then in a quite long period, they would be sold to individuals through stock sales. Of course, the state would continue its control or monopoly in certain branches of the economy, such as defence contract, the nuclear power industry, infrastructure etc. Moreover, the state was able to dispose of assets through stock shares in the economy (Current Digest, 1990f).

To reach destatisation and privatisation, there were devices and transitional forms. At the initial stages, investment funds would be established, as a transitional form of ownership which was of non-individual ownership, to start the process of converting state-owned enterprises to joint-stock companies. state-owned enterprises would be given a book value by the state property fund, for which a packet of stocks would be issued and then passed on to the appropriate investment fund. So those enterprises would become joint-stock companies under the investment funds. These funds would perform as owners, and receive dividends which would be turned over to the budget of the Union, Republican or local governments who created the funds. Over time, through these funds, the stocks would be sold to the population, to workers of the enterprises involved and to foreign investors (Hewett,

1990/91).

It was fairly reasonable to expect a pattern of mixed economy in the sense that state sector and private sector coexisted in the course of reform in the Soviet Union. For instance, the Law on the Enterprise adopted in 1990 (Aslund, 1991), superseding the Law on the State Enterprise in 1987, covered all types of business entities, e.g. state owned enterprise, cooperatives, family firms, joint ventures and others. Private companies were encouraged to develop (Hanson, 1990). Nevertheless, one should not overestimate the degree of destatisation, particularly privatisation of ownership in the Soviet economy. As expected by the planners of 1990 reform package including the authors of Shatalin's plan, by the end of the reform course, there would be state and joint-stock companies, cooperatives, enterprises operating on a leasehold basis, and private business. It was anticipated by the Presidential plan that of those ownerships, about 40 percent of the economic activities would be operated by joint-stock companies, about 10 percent to 15 percent by state enterprises and cooperatives, only about 5% of the total by private business entities (Hewett, 1990/91).

5.2.3 Pricing mechanism

Decontrolling prices, or liberalisation of prices control, was one of the key components of the 1990 reform plans. The general principle for reform of the price system set by the Presidential plan was to rely on market mechanism to set the bulk of prices (Current Digest, 1990f). But the speed of change on wholesale prices and retail prices were different.

With the beginning stages ongoing, prices of products of state orders would be set by negotiations between the enterprises and the Union Contractual System. And they could be imposed by central authority if

no agreement was reached. State controlled prices would be applied in the case of monopolistic products. Apart from these, most wholesale prices for manufactured goods would be fully negotiated between buyers and sellers (Hewett, 1990/91).

Retail prices reform constituted one of the most sensitive areas, as it had always been, in the 1990 reform plans, especially in the Presidential plan. At the beginning of the reform period, they would be frozen in order to avoid causing hyperinflation and dissatisfaction among the population. Later on, they would be liberated gradually with one exception. That was, about 100-150 goods would continue to enjoy subsidisation from the state for their prices throughout the reform process. The complete picture at the end of the proposed reform period would look like this: the bulk of consumer goods should move freely to market supply and demand, and only a few goods or necessities would be priced by the state with subsidisation.

In summary, prices would take various forms in the Soviet economy after the reform. At the wholesale level there would exist three types of prices for goods: (1) state set prices; (2) partially state-set prices for state order products; (3) free prices set by negotiations between non-state buyers and sellers on the market. For retail prices, there would be two forms: state subsidised prices and free-market prices.

5.2.4 Other issues

In this part, two main issues were to be discussed briefly. They are the new policy for foreign economic activities and reform in the rural economy.

It was in the 1990 reform plans that the importance of opening up the Soviet economy to the outside world was perceived. They called for

opening trade with, and receiving investment from, the rest of the global economy where the Western market economy dominates. The general thrust of the new regulations in foreign economic activities would be, the Presidential plan said, to foster the rapid integration of the Soviet economy into the world economy through encouraging existing enterprises to export and foreign businessmen to invest in the Soviet Union. Joint ventures with foreign partners were strongly encouraged through measures such as exemption or a low rate of taxation on them. The relevant legislation specified that joint ventures would not be subject to centrally determined plans and exempted them from taxes on profits during the first two years of operation (Schroeder, 1991). A subsequent amendment allowed foreign companies to have majority ownership of ventures, and a decree issued in October 1990 authorised 100 percent foreign ownership of enterprises on the Soviet territory (Johnson & Kroll, 1991).

Furthermore, the presidential plan expected that the Ruble would be gradually made convertible on the current account and even on the capital account. Its exchange rate would be determined in foreign exchange markets where about ten to fifteen commercial banks would enjoy full rights to buy and sell foreign exchanges (Hewett, 1990/91).

In the field of rural reform, a great step forward was taken in the 1990 Presidential plan. A massive land reform would begin, along with the privatisation of farming and farm-related services. The goal was to reconstitute some of the 60,000 State and collective farms into private or cooperative farms, while breaking up others for the creation of 150,000-180,000 small farms (Current Digest, 1990f). These farms would enjoy economic freedom in growing or raising what they wish, and could sell their products at market prices. Privatisation in transportation and food-processing industries would take place which was hoped to lead to a rapid improvement in the quantity and quality of

food available to the population (Hewett, 1990/91).

Unlike the reform package of 1987, 1990 reform plans, particularly the Presidential plan, were produced in a rush against a background of complex of social, political and economic crisis in the country. The conflicts and vagueness of them were therefore unavoidable. Generally speaking, however, the 1990 reform plans marked a turning point in the process of economic reform in the former Soviet Union from the moderate reform to radical transformation of the centrally planned economy.

5.3 Reform proposals in 1991

1991, the last year of the former Soviet Union, witnessed numerous events happened in the country, but few actions on economic reform at all Union level. In the last programme for economic reform in the Soviet Union, the Minister Pavlov's official anticrisis programme (Current Digest, 1991e), nothing new was announced. It was said that the new blueprint, introduced after the "500 Day" programme was ruled out in the autumn of 1990, was based and borrowed from those previous, ill-fated proposals. It called for a genuine market-oriented reform while some centralised measures were to be imposed in order to stabilise the country's economy. However, there was one step worth note. It was the draft law on the denationalisation and privatisation of industry approved by the Union Council and the Council of Nationalities (Johnson & Kroll, 1991).

In 1991, with the disintegrating of the USSR, the Russian republic played an important role in economic reform in the Union. Because it is territorially the major body of the former USSR, either in physical size or in political-economic affairs, the Russian reform programme in 1991 --in essence, the Shatalin plan-- should not be omitted in this thesis.

5.3.1 Privatisation

The draft law on the denationalisation and privatisation spelled out for the first time the principle of the process. According to it, privatisation should be undertaken predominantly with compensation, i.e., institutions or individuals who acquired state-owned property must pay for it. The architects of the law thus rejected the widely-debated idea of free and equal distribution of state-owned property to the work force by denationalisation and privatisation (Current Digest, 1991j). The state property fund was established. Its function was to assess the proper values of state property as preparatory step for destatisation and privatisation (Current Digest, 1991j).

Possible forms of privatisation included direct acquisitions of factories by their workers, reconstituting of establishments into joint-stock companies, and leasing with right of subsequent purchase. Under the law, if workers should refuse to buy their factory, it might be auctioned off or otherwise sold to the most appropriate bidder (Johnson & Kroll, 1991).

Land reform was declared to be carried out soon in the country (Current Digest, 1991a). The ineffectively used land on collective and state farms, after being in the hands of local Soviets in the form of a special land fund, would be given to newly created peasant farms, leaseholders and agricultural cooperatives.

As far as the property division between the Union and the republics was concerned, the law said that individual republics might extend extra preferences to businesses within their jurisdiction.

5.3.2 Price reform

Price reform was one of the few foci of the economic reform in the Soviet Union in 1991. Following the line of the Presidential reform plan of 1990, there was a decree of the President in April 1991, for implementing retail price revision and reform (Current Digest, 1991c). First of all, a ceiling price was set by the central government after agreement with the republics for increasing a number of consumer goods. For example, the prices of meat, bread, grains and baby foods would not go up over 200 percent, eggs, tea and oils not over 100 percent (Current Digest, 1991c). More consumer goods were said to be freely priced after price revision. But the central government and republics would play a significant part in monitoring and regulating the price reform. At this stage, price formation was still largely in the hands of central or local authorities, including fixing the newly revised prices and setting limit for price change. It was repeatedly stressed that compensation for the increase of retail price to Soviet citizens would be provided properly by the state.

5.3.3 Russian reform programme

Faced with economic chaos and a lack of effective leadership on the part of the all-Union government, the RSFSR had taken upon itself the task of devising its own programme of economic stabilisation and reform. The initial proposals were discussed as early as April, 1991 (Tedstrom, 1991c), and the outline was roughly completed in October of that year (Bush, 1991). Despite the vagueness and hastiness of the programme presented, from the general principles of the programme, it appeared as the most radical and promising plan for reforming the Russian economy during the period of our discussion. It followed a shock therapy in relation to the speed of the transformation to a market economy. It went nearly all the way in liberalising prices and wages. It promised to transform the way in which foreign trade was conducted, and it offered more immediate prospects than many predecessors for convertibility of

the Ruble. But, the detail of the preconditions for a convertible ruble was not provided. Here only some critical points of our interest were covered briefly as the programme itself had not proved to be a complete blueprint as yet.

Liberalisation of prices It was stated that to make a switch to market prices in one motion was a severe, forced, but necessary measure. To be specific, the wholesale prices of major industrial goods such as fuel and raw materials and of farm produce would remain under government control. So would the retail prices of essential foodstuffs, medicines, public utilities, municipal transport, and children's goods. Liberalisation of other prices of goods and services would be completed in about six month.

Privatisation The Russian Republic would start the process of privatisation in the small and medium enterprises in the services sector, trade, industry and transport. As to the operational forms of privatisation, it was said that shares in the larger industrial enterprises would be issued soon. Initially, shares would be divided between the state and employees of the respective factories. Subsequently, the state shares would be offered to the general public at market prices. But there was no statement about the proportion of the shares that would be sold to the work force in the factories.

In agriculture, loss-making kolkhozes would be broken up, and their land would be transferred to private farmers and to those who wished to set up small- and medium-sized "peasant trust enterprises". A massive boost for private farms was planned.

External economic activity By opening up foreign trade and moving towards a fully convertible currency, foreign business was allowed to sell products for Rubles, which then could be used for investment in the

republic. Free economic zone was proposed and began to be established. It seemed that Yeltsin's government strongly encouraged foreign economic activities in the republic. Notwithstanding, the Russian program did not convincingly give the practical opportunity for foreign investors to invest in the country. For example, some essential issues such as buying of land or shares of Russian undertakings was not clearly discussed or mentioned.

5.4 Towards a Soviet-type market economy

On the basis of the concentrated discussion of economic reform proposals, primarily the two reform packages published in 1987 and 1990, a summary of the nature and direction of the reform in the former Soviet Union would be given in the language of theoretical assumptions set in the analytical framework. Following the structure of 4.4, Chapter Four, two issues would be studied in this section. Firstly, a review of the changes on the basic structures of economic system is necessary. Then the present author attempted to describe the features of the prospective model of the economic system intended by the reformers in the Soviet Union.

Before we go to the core matter, a technical question must be resolved. That is the relative weight of the two reform packages in evaluating the nature of the reform in the country as the principal lines of them differed in some extent. Here the two of them would be integrated as one package where it was possible. For example, one issue was dealt with in one of the reform packages mainly. And in the case of any conflict or different resolution on any matter in the two packages, the viewpoints of the 1990 reform plans would be taken into account instead of the 1987 reform package.

5.4.1 Basics of the economic system being changed

The question to be answered in this part is what has been done on paper in altering the critical elements of the central planning economy as a kind of economic system? The four structures, i.e. structure of decision-making power, information, motivation and ownership would be examined in order.

Decision-making structure It is interesting to notice that the direction of modifying the structure of decision-making power set by the 1987 reform package goes to both ends of the spectrum: recentralisation and decentralisation, and both economic and administrative decentralisation. On the one hand, the existing top organisations were reorganised with its decision-making power reduced to long-term and strategic programming of the national economic development. Meanwhile, new central-level committees were created with decision-making power recentralised from the ministries. On the other hand, the strength of republican and local governments were increased through endorsement of some of the decision-making rights from the hands of all-union agencies in relation to the management of regional economic activities. What is the most significant change in the process of decentralisation lied in the strengthening autonomy of the state-owned enterprises as the result of loosening central planning control.

Substantial change occurred correspondingly in the means of bringing about the expected outcome of the decisions. Command orders no longer played an important part with the increasing role of economic instruments and norms. But the exception should not be neglected, i.e. the remained state orders for a quite long time, and the state controlled prices for some goods.

A genuine economic decentralisation could be expected from the destatisation and privatisation which would make the enterprises the independent producers.

Information structure Following the main lines of change in the structure of decision-making power, information structure was supposed to work partly in different way. The vertical flow of the message was limited to a small volume, while the horizontal movement of the information between suppliers and demanders, producers and consumers would be prevailing. Simultaneously, orders and instructions would be replaced by norms, prices and so on.

With reforms on the price system unfolding, prices of various categories, e.g. state-set prices, negotiated prices and free market prices, would become the critical signals for economic activities.

As far as the function of the coordination of the economy was concerned, one should say that market forces would work in the process of marketising the economy. At the same time, significant non-market forces would still remain in regulating and controlling the economy, due to the remnant of the old central planning system in its broad sense. It is, therefore, reasonable to expect the new economic system designed by the reform proposals would coordinate the economic activities largely through market forces under the shadow of state interference.

Motivation structure The radical reform plan in the Soviet Union would create incentives for actions of agents in the economy, i.e. individuals and enterprises which were more powerful than the existing prevailing ones. The proposal for self-management in enterprises increased the interests of workers in running the business more efficiently.

Requirement for full economic accountability and self-financing would drive the enterprise to improving its performance in order to get reward. And it would produce the same effect on ministries because their abilities of full economic accountability would depend on the

performance of the enterprises subordinate to them.

Destatisation and privatisation threw light on strongly motivating individuals for efficient working. Unemployment and bankruptcy, from the negative side, enforced the role of material incentives for workers.

Ownership structure In respect of ownership, the reform plan showed its most revolutionary character. Individual ownership of productive assets was recognised and guaranteed in the Soviet economy. Moreover, a diversified pattern of ownership structure was created. The state-owned sector, joint-stock business and private-owned entities would work together. The inclination towards privatisation through destatisation would result in a relatively large private sector in the economy.

However, owing to the vagueness of the reform design on this matter, the operation of the ex-state-owned enterprises seemed not clearly explored. Simply assuming that the basic principle of running a joint-stock company in an existing market economy would not work because the mode of operating those enterprises artificially made as joint-stock companies would presumably differ in one way or the other from the original samples in the West.

5.4.2 The Soviet-type market economy

The task of this part seemed more or less easier than its counterpart in Chapter 4, 4.4.2, thanks to the complete blueprints of Soviet economic reform in the 1990s. More information had been provided, especially by the publication of the 1990 reform plans. But there is no reason to be optimistic for achieving a satisfactory result of the study.

It was obvious, from the discussions up to now, that the radical reform

of the Soviet economy would lead the country thoroughly to a market economy. But the prospective model would not be simply built up by joining the family of Western-style market economies. The future economic system was defined as a market economy with Soviet features.

To reveal the nature of the Soviet-type market economy, two steps should be taken. Firstly, like what has been tried in Chapter Four, 4.4.2, stages of transforming the centralised planning economy to a market economy implied in the reform proposals in the Soviet Union would be shown. The destination of the process would be the prospective model of the Soviet-type market economy. Then, space would be spent on analysing the basic differences between a Soviet-type market economy and the normal Western-style market economy.

Panel 5.3.2 Major Stages in Transition of the Planned economy In Former Soviet Union

	<u>Planning control</u>	<u>Market forces</u>
Stage 1	P~	M*
Stage 2	P~~	M**

Notes:

P~: Central planning control was loosened through administrative decentralisation in dealing with sectoral and regional economies, and enterprises got more autonomous rights in decision making. But substantial planning control remained;

P~~: No significant planning control was conceived through operational plans. Only a limited degree of State intervention was retained by the means of the State order system and State controlled prices and so on;

M*: Market forces played roles in limited areas, such as influencing the formation of some prices of small-valued consumer goods. Economic

instruments were given more power in regulating economic activities; M**:

The economy was, to a large extent, marketised. In the main spheres of economic activities a full-blooded market mechanism was expected.

From the panel, one could point out that Stage 1 represents the intention of the 1987 reform package while Stage 2 is the ideal end of 1990 reform plans. It is interesting to notice that the goal of the 1990 Presidential reform plan was to achieve a market economy with strong shadow of planned control. This is called a Soviet-type market economy. But the Shatalin plan, and those based on it like the Russian reform programme, designated a more free market economy within which the state would be pulled out of the economy as the commander in a centrally planned economy.

Now, the question arises: what is the boundary between the Soviet-type market economy and the normal market economy? Generally speaking, the Soviet-type market economy would differ from the existing market economy from both sides: it would be, on the one hand, more classic than the normal market economy, because the architects of the economic model learned only the basics of a market economy, probably from textbooks. Market mechanism was thought naively as the powerful gun to kill the diseases of the planned economy.

On the other hand, however, the scope of the market mechanism in the Soviet-type economy would depend on the ability of the state control, and its ability to achieve these objectives through non-directive means. As a result, it would grow as a market economy with great state intervention which would be the legacy of the ex-planned economy. Establishing the market economy from the basis of a centralised planning system and by the designers and officials deeply involved in the existing system, it is hard to assume a free market economy without

influential state intervention. Consideration of keeping stable living standards for the population, protecting the vested interest group, would result in a compromise. The believed role and responsibility of the state in the economy, at least in determining the development of the country for long term future purpose, would contribute to the formation of the Soviet-type market economy. For example, the existence of the significant state-owned joint-stock companies would influence the operation of the market mechanism in principle, as it is in the Western economy. To guarantee the living standards of the population, some products would continue to enjoy subsidies which definitely would distort the price structure set on the market.

Finally, a few words about the Russian reform objective is necessary. It would go further towards a market economy than the plans of the former Soviet Union. Whether it would reach a genuine Western-style market economy or not is not the question of this thesis, but one could expect this direction of the transformation in this country.

Chapter 6: Searching For Efficient Economic Systems: A Comparison

After the two chapters dealing with the economic transformations in China and the Soviet Union respectively, in this chapter a comparative study is to be conducted on the proposals of economic reforms in China and the Soviet Union in the periods of our discussion. It is also part of our conclusion about the reforming efforts on paper in the two large centrally planned economies. Based on the materials provided in the previous chapters, Chapter Four and Five, the comparison is done on several selected issues. First of all, reforming efforts in some essential aspects of the centrally planned economy in the two countries is compared in their depth as well as width. Of these aspects we include the central planning control, state-owned enterprises, market mechanism, opening-up and the rural economy. In the second section of this chapter, comparison of the proposed changes in the two economies is conducted in terms of a theoretical analysis as established in the analytical framework of this thesis. Structures and major features of the prospective models of economic systems designed by the reformers in China and the former Soviet Union is the subject. Then, the author is going to contrast the strategies and technologies of the economic reforms embodied in the proposals in these two cases in order to reveal some relations between the proposals and the strategies required for transformation of the centrally planned economy. In this final section, the two models of carrying out the transformation in the ex-CPEs in our two cases is also to be discussed briefly.

6.1 Similarities and differences

As discussed in our analytical framework, there should be no argument that to reveal the nature of the centrally planned economy in general in a limited space, at least the following three interrelated aspects must be

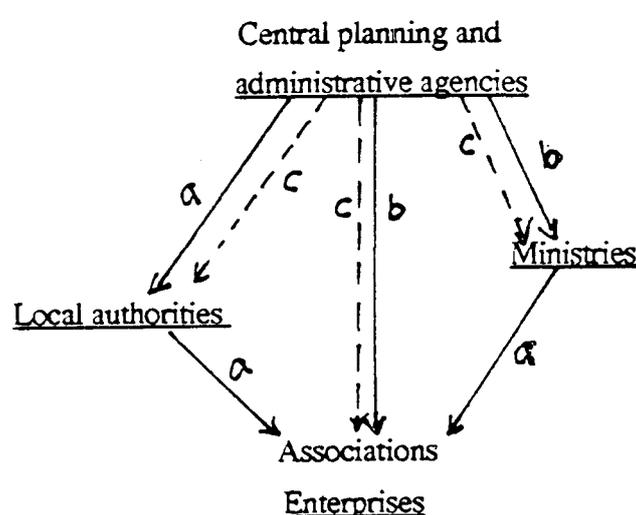
touched on in terms of any altering of the system. They are, (1) the central planning control; (2) the state-owned enterprises; (3) market mechanism in economic operations. In the context of the present study, two more issues should be added in brief referring to the opening-up of the closed economy and reforming the mechanism of organising agricultural production. As a matter of fact, all these issues have been paid attention to, more or less impressively, in the reform proposals in China and the Soviet Union. But the rank of importance of and degree of the change on each of the aspects in the two cases seem to be different, due to the different problems in the Chinese and the Soviet economies. Now, it is time to conduct the comparison between the two cases to trace out a general tendency of economic transformation in centrally planned economy. In addition to telling what it is, the author also tried to answer why it is in a brief way, though. But it is not the author's intention to judge which model of transformation was more successful than the other. It was commonly agreed that economic reform in China has been going well since 1978, whereas the former Soviet Union collapsed before many of its reform plans could be put into action. There is therefore no solid ground for such a comparison.

6.1.1 Central planning control and decentralisation

As the key character of the centrally planned economy, central planning control ought to be put on the top of the list of priorities for being restructured. The fact is that it came first as the starting point of economic reform in both of the countries. And even the changes went at same pace in the initial stages in our two cases. For example, calling for decentralising the over-concentrated decision-making power at the centre, measures were adopted for loosening the practical planning control from the top in both economies. This is a common characteristic of the reform proposals, either sectoral or comprehensive in China's case, and the 1987 package and 1990 Presidential plan in the Soviet case.

However, where detailed arrangements were concerned, decentralisation went in three ways in our two countries: (a) from the central planning agencies to local planning authorities; (b) from the central administrative agencies to ministries and lower economic institutions, i.e., enterprises; (c) switching the focus of the work by central agencies. To help understand the situation, panel 6.1.1 is drawn below.

Panel 6.1.1 Three roads of loosening central planning control



Road (a) is mainly taken by Chinese reformers since the power of the local planning agencies was strengthened greatly in the course of reform. The case of special economic zones, the opened-up coastal cities and special regions and Hainan Province, among other things discussed in section 4.1.2, chapter 4, supports our argument. Meanwhile, the Soviet reformers were very cautious to decentralise the decision-making power to the republics. In their 1987 reform package and 1990 reform plans, e.g. in the Presidential plan and Shatalin programme this issue was also a very sensitive subject (see section 5.1.1, 5.2.1, chapter Five). This is because the position of the republics in political and economic structures of the former Soviet Union was entirely different from, say, the provinces in China. The two economies were organised under different circumstances. Relatively speaking, Chinese economy is of

cellular. In China each level of administration has an overall responsibility for its subordinate levels (Donnithorne, 1967). The central government's control was not as direct and strict as it was in the former Soviet Union where the economy was highly integrated and controlled by Moscow. The fear of losing control over the republics which showed a growing inclination of independence from the Union had hindered genuine decentralisation from the centre in the former Soviet Union. This was one of the reasons, for the present author, that Shatalin plan could not be accepted by the Government. Obviously, the Shatalin plan proposed a much looser relation between the republics and the centre. Relatively speaking, Chinese reformers were more comfortable than their Soviet colleagues on this issue. As far as the second destination of decentralisation (road (b)) is concerned, things seem complicated. Chinese reformers designated a gradual decentralisation of enterprises but retaining the power of ministries, as there was no sign of weakening the ministries in the relevant proposals and measures. In the Soviet Union, a recentralisation was taken in the 1987 reform package in the distribution of decision-making authorities between the central agencies and the ministries, while associations in-between the ministries and enterprises were given some power from both the central and ministerial agencies. The reason for the difference in the two countries may be found in structural arrangement of the administrative system. In China, ministries have been part of the central authority to local governments and enterprises in particular. In the Soviet Union, as noted in section 5.1.1, chapter Five, ministries in Moscow formed a powerful individual level in the system of administration which subordinated to the top(all Union level) authority and above the republics and enterprises. To weaken the power of the ministries was one of the important goals of 1987 reform plans, not to say reform programmes in 1990s. The third road of loosening the central control would result in decentralisation to the levels of local authorities, ministries and enterprises (associations), depending on the

contents and degrees of power laid down by the central authorities when their concerns were switched from detailed and short-term plans to long-term and prospective programmes. This tendency occurred in both of our cases, though there is of course slight different result as the lower echelons gained the decision-making power in different degrees and forms. On China's side, both local governments and enterprises gained more power under the policy of road (c), while in the Soviet case, associations and enterprises, other than ministries or republican planning agencies, were promised more power from the change of foci of the central agency.

So it is interesting to note that the focus of improving central planning control through redivision of decision-making authorities in the Soviet reform plans was put on strengthening the power at the centre--the all-Union level-- and according more autonomous rights to associations and enterprises, while reducing the role of ministries in economic administration and confining the power of republics. In China, the power of the central institutions, including ministries in some cases, was weakened with some decision-making authorities being transferred to local agencies and enterprises.

Here it is necessary to stress that loosening central planning control does not necessarily lead to non-planning regulation in the economy. For instance, as it is in reality, local and ministerial authorities would continue the planning or administrative control over the economy. This is the phenomenon of so-called administrative decentralisation (Bornstein, 1977). From our cases one could discover the very fact that the extent of introducing market forces did not go at same pace with the loosening of the central planning control. Here, a review of the discussions of section 4.4.2 and 5.4.2 in chapter Four and Five would be helpful for this argument. To the present author, the lag of the progress of market forces behind the development of reducing central planning

control could possibly be explained, to a large extent, by the substitution of local or ministerial administrative control from the hands of central authorities. Nevertheless, decentralisation from the top is the necessary, though not sufficient, prerequisite for transforming the planned economy to a market-oriented economy.

The fact that there was not much essential difference in the arrangement for changing the central planning control in China and the Soviet Union can be explained from the very similarity of the economic system in this respect especially. For almost all the problems which occurred in the Chinese and Soviet economies, the over-centralised control of the economic activities had been blamed. In logic and in practice, loosening central planning control was expected to solve the problems to some extent.

6.1.2 State-owned enterprises and privatisation

It is needless to stress that the performance of state-owned industrial enterprises, medium- and large-sized ones in particular, had been more of a longstanding problem in centrally planned economies. Great efforts had been made to search for prescriptions. Now, in the proposals of the Chinese and the Soviet reforms in 1980s and early 1990s, the old road was still followed but a new approach was conceived. It was commonly recognised in the two cases that the enterprises should be able to make some decisions on their production, and the related issues, to be the producer in its genuine sense. To achieve this goal, reform architects in the two economies put forward different prescriptions.

After the usual initial steps towards endorsing some certain sorts of autonomous rights to the state-owned enterprises as the result of loosening central planning control over them, the Chinese and the Soviet endeavours started to diverge. In China, as discussed in section 4.1.3

and 4.2.1 in Chapter Four, thinking followed the way to relax the tension between the administrative institutions and the enterprises formed in the long past when the latter had been regarded as the subordinate agencies of the former. Attention was paid to motivate the incentives and initiatives of the enterprises as profit-seeking producers. The contract responsibility system in state-owned business was attempted as a comprehensive remedial package which was expected to play a crucial role for increasing the sense of economic accountability and easing the defects of soft budget constraint endemic in the state-owned enterprises (Kornai, 1980). In the Soviet Union, something similar was called for but not in great effort, for example, self-financing and full accountability of the enterprises in 1987 reform package (see section 5.1.2). In 1990 and afterwards, the most radical and revolutionary measure was produced which marked the remarkable step in the history of economic reform not only in the Soviet economy but also in the centrally planned economy as a whole.¹ Attempt at improving the performance of the state-owned enterprises within the existing frame of ownership appeared to be abandoned, as revealed by the analysis in section 5.2.2 and 5.3.2 of Chapter Five. Along with the destatisation proposal, the former State-owned entities would be expected to operate under different circumstances and rules which were thought to be effective to overcome the endemic problems affecting the activities of these undertakings. Without detailed discussion of the operation of the destatised enterprises provided by the architects, one point should at least be clear, i.e. the relation between the enterprises and the State resulted from mainly the ownership would be fundamentally changed. State intervention was said to be kept to a minimum level, except state's purchase of a few important goods.

The trial of stock-share companies under non-individual ownership

¹ The fact that the similar proposals were published in Poland, Hungary and other Eastern European countries earlier should not deny the argument because those proposals were produced under the condition of anti-communist political changes after 1989.

among former state-owned enterprises in China in the 1990s indicated the reluctance for a basic change of the ownership of the large and medium-sized state-owned entities. This may be explained by the ideological obstacles. Privatisation, among other things, was officially believed to be against socialist principles. However, the 1992 policy for economic reform implied the possibility of a gradual breakthrough in practicality.

Difficulties in reforming the state-owned enterprises arose not only from their more complex internal and external relationships in the economy, but also from the very fact that they had welfare function to their staff, too. In many cases welfare of the people, and their families, working in state-owned enterprises greatly depended on the undertakings. Any change of the status of the enterprises would negatively affect people involved. This made the matter much more complicated than it looked, and reformers had to be very cautious about it.

By contrasting the efforts of improving the efficiency of the state-owned enterprises in our two countries, one could hardly find the prescriptions other than thinking in these ways: 1) providing more freedom on decision-making to the enterprises by reducing and revising planned indicators; 2) changing management style by transferring the state-owned enterprises into stock-share companies with the state being the major share holder; 3) privatizing the state-owned undertakings. It is obvious that China has moved towards the second stage of the reform, while the Soviets proposed a resolution of the stage 3.

6.1.3 Market mechanism and marketisation

Introducing some factors of market mechanism into and marketisation of the planned economy seemed to be the two major steps in altering the

economic system in the two countries. The difference of the two resolutions lies in the degree of transforming the planned economy into one approaching a market economy.

Introducing market factors into a planned economy referred in principle to partial market mechanisms in price formation, establishing some kinds of markets for consumer goods and the so-called economic means of government regulating instruments. This sort of measure was accepted on a large scale in China's economy where market forces were supposed to work in the sphere with central control. It should be agreed that massive achievements have been gained in this field in China since the market mechanism played a more and more important part in the economy. Here the relative successful marketisation of the collective, private and foreign related sectors was significant in contributing to the reform of the centrally planned economy in China. This was particularly clear when compared with the Soviet case which lacked the influence or demonstration effect of successful attempt at marketisation in any sector of the economy. In China's case it is also especially notable that some of the instruments used by the government in a market economy were taken, in various scale, in the reformed Chinese economy. For instance, taxes, interest rate and exchange rate were accorded significance in economic life there (see section 4.2.2 and 4.3. in chapter Four).

Price formation in the reformed economies of the two countries is a good example for examining the role of market forces introduced. It seems that in both cases a multi-tier price setting system combining market mechanism and planning control had been adopted as the solution of the reform of the pricing mechanism (see section 4.3.2 of Chapter Four, section 5.2.3 and 5.3.2 of Chapter Five). Even in the blueprint of marketising the planned economy in the Soviet Union put forward by the Presidential plan in 1990 three categories of prices at

wholesale level would exist instead of a sole market price.

Marketisation of a large share of state-owned business was one of the endeavours in China's reform. Selected sectors and regions were on the way to approaching a fully fledged market mechanism, e.g. agriculture and special economic regions (section 4.1.1 and 4.1.2 of Chapter Four).

Well, Soviet reformers showed their encourage in the 1990s reform plans, for example, Shatalin plan, and even the Presidential plan, by calling for completely switching the economy into a Soviet-type market economy, though the Shatalin programme went further in this respect than the Presidential plan. Marketisation of the existing planned economy, which was the original and typical sample of this type of economic system, sounded possible in theory, accompanied by destatisation of the state-owned enterprises. Lacking the necessary details of how the process of marketisation would go on, one may assume that at least the basic rules for a market economy to work would be followed in the new type of economy. The problem here is by what means do we reach the destination? In this respect, the road of introducing market forces into the key parts of the system for the market mechanism to work properly was followed, for instance, price liberation in the initial stages of the transformation (see section 5.2.3 and 5.3.2 of Chapter Five).

6.1.4 Other issues

In this section two issues were chosen according to their importance in the reform processes in China and the Soviet Union. First came the opening-up of the closed economy. And then the reform effort in agricultural production, or in a broader range, the rural economy, was to be put in perspective and compared.

The policy of opening-up the closed planned economy took a remarkable position in the process of economic reform in China (see section 4.1.2 and 4.3 of Chapter Four). This was, perhaps, the most successful part of the reform efforts proposed and implemented in China without much argument. Meanwhile, nothing noticeable occurred in the Soviet economy in this field except the measure for introducing foreign direct investment in the country in 1987. However, a convertible ruble was mentioned in the reform plans in the 1990s in both the Shatalin plan and the Presidential plan. Foreign financial aid was required for the reform. Nevertheless, the Soviets or Russians were still not ready to open wide its door to foreign investors. They were unable to provide the necessary preconditions for a genuine opening-up.

China's policy in opening up its economy to the world market and attracting substantial amounts of foreign investment in its domestic economy should be attributed partly to the contribution of the Overseas Chinese and the existence of Hong Kong and Taiwan, advantages the former Soviet Union could not take. The legacy of China's pre-communist history as the semi-colonies of a number of developed countries, such as Great Britain, United States and Japan, put the country more or less closer to the West than the former Soviet Union. At the same time, the close economic relation of the former Soviet Union with the CMEA did contribute to its isolation from the West economically.

As to rural reform, it is safe to say that China has marched far ahead. Although in official documents no privatisation of the land was approved and confirmed, the latest development of the leasing system on land use and management in rural area implied this resolution. By the series of reform measures taken in the rural sector in the Chinese economy, a marketised economy was expected. In addition, it seemed very possible for this kind of endeavour to be successful in China where

economic development was in earlier stages than the Soviet economy.

The same sort of prescriptions for rural areas in the Soviet Union encountered obstacles, despite the great efforts by the reformers there. The difficulties occurred in agricultural production seemed more severe in the Chinese economy than in the Soviet economy, according to the importance of this sector in their economies. The Soviet economy faced trouble agricultural production as well, but the relative position it took and the ability of the economy of importing grains eased, to a certain degree, the urgency of the problem. There may be reasons for the difficulties to make effective reform in the rural economy, which could be traced through the tradition and techniques of organising the production, the longer time of planned control, and the inertia in the Soviet agriculture. Simple prescriptions like those adopted in China might not be powerful enough to kill the disease in the Soviet agriculture. As a matter of fact, China has a larger rural population, a shorter history of planned control and less advanced techniques of production in agriculture than the Soviet Union, which provided more room for manoeuvre towards effective change from planned control. At the same time, in the Soviet case more radical and powerful measures such as massive privatisation of the land were required. However, the different response of the peasants to the same reform measure in China and the former Soviet Union may also be explained by the quality of the peasantry in the two countries. In the Soviet Union peasants had lost interest and love for the land, or rather, their enthusiasm had been destroyed. This was especially true among the young generation. While in China the damage to the peasantry was not as severe as in the Soviet case. Nevertheless, it is reasonable to say that a private rural economy was the aim of both Chinese and Soviet (Russian) economic transformation.

6.2. Two models of economic system

What type of economic system would be established by the economic reforms in China and the former Soviet Union? A modified planned economy or a regulated market economy? Or something in the middle of the planned and market economies? From the discussions above, one is able to answer this question in terms of the theory of economic systems and taking a comparative perspective .

In Chapter Four (section 4.4) and Five (section 5.5) the basic structures of the economic system in the new economies in China and the Soviet Union were described. Here we can contrast in the first place the characteristics of each type of reformed economy, and then their distance from planned and market economies.

6.2.1 Decision-making structure

In China's reform plans, location of decision-making moved down from the top to the lower echelons and closer to enterprises. Local authorities in-between the centre and enterprises played a more important part in decision-making than they were in pre-reformed economy.

In the Soviet Union, the intention of reform was to weaken the power of the echelons in-between the central (all-Union level) and enterprises (associations), for instance ministries and republican authorities. And it was logical to expect a decentralised decision-making structure after the destatisation and privatisation of the ex-state-owned enterprises.

As to the means of implementing any decision, command and instruction of the authorities would be significant in the course of reform but the authorities would pay more attention to influence the consequences of the action of the participants, e.g. enterprises, rather than controlling directly the action of the participants. In this respect, the Soviets

proposed a more thorough transition from the traditional centralised decision-making structure in its 1990s reform plans (see section 5.2 and 5.3 of Chapter Five). Because, with destatisation and privatisation unfolding, decision making would be done on the spot in a large part of the economy.

The decision-making structure in the reformed economy of China and the former Soviet Union would be, therefore, largely decentralised, which is closer to a market economy and farther from the existing traditional planned economy (see section 2.1.1, Chapter Two). However, the fact that planned or administrative control would be strong in either the Chinese or the Soviet model after the transition would require to some extent a bit of centralised decision-making power, particularly in China's case.

6.2.1 Information structure

While giving more play to market prices and other monetary means as the signals in the economy, Chinese reformers decided to retain vertical flow of the information in large state-owned enterprises for a certain long time. So the market mechanism would work together with planning control to coordinate economic activities.

In the Soviet reform plans, particularly the 1990 Presidential plan and the proposals afterwards, a quasi-market information structure was assumed. For example, with the state withdrawing from planning control over a large part of the economy, horizontal flow of information in the economy would be the essential form of transmitting the messages, such as prices, quantities and other monetary means.

It is obvious that the information structure designated by the Soviet reformers would be more similar to a market type economy, while the

Chinese one would stay a bit farther from the market economy. Of course, both the Chinese and the Soviet models have gone away from the centrally planned economy.

6.2.3 Motivation Structure

In changing the nature of the existing non-material motivation structure, Chinese reformers paid much attention to motivating the population by material incentives to participate in economic activities, either in the public sector or in private business. Meanwhile, Soviet reformers received little response from the populace for establishing a material-oriented motivation structure.

The difference in motivation structure between a market and a planned economy was revealed in the Chinese model of reform, especially in non-state sectors. In the Soviet case, incentives for working harder in the public sector seemed insufficient, and the intention of the reformers in transforming the motivation structure had to be on encouraging people to run their own business and massively privatising former state property. It is true that both the economies after the reforms would establish a market-like motivation structure as defined in section 2.1.3, Chapter Two.

6.2.4 Ownership structure

In ownership structure, the Chinese-type market economy and Soviet-type market economy show their essential difference. Chinese reformers would not go for a largely private market economy as the Soviets would. In China state enterprises were put on the agenda for switching into stock-share companies but the nature of the non-individual ownership would not be altered in many cases. These large entities would undoubtedly take an important position in the new economy,

although private business mushroomed and played more and more significant role in the economy (section 4.1.4, Chapter Four).

The Soviet reformers called for massive destatisation and privatisation of the state-owned enterprises and in rural areas apart from a few exceptional cases. So non-individual ownership would prevail in the prospective economy. This kind of blueprint, if implemented, would push the Soviet economy very close to a genuine market economy, while China would remain half way towards a market economy in this aspect.

To summarise the similarities and differences in the basics of the economic systems proposed by the Chinese and Soviet reform plans and their respective distances from planned and market economies, Panel 6.2.1 would be helpful.

Despite the similarities in the reform designs of our two countries that qualify both the economies as market-oriented ones, the differences, however, made the two economies as two types of market economy rather than one. What is significant here is that the differences of the proposed market economies would be more meaningful than the differences which existed in the traditional centrally planned economies in China and the Soviet Union. The discussion above and also in sections 4.4.2 and 5.4.2 of the two previous chapters enabled one to draw this conclusion. As a matter of fact, the question of the depth of the transformations in the two economies were to be answered in the next section of this chapter.

6.3 Strategies for economic reform

Studies of economic reform should not only include the contents of the reform plans, but also the strategies chosen to complete them. Here the question is how to pave the way technically to reach the final

Panel 6.2.1 Major features of Chinese and Soviet economic models

Structures	Planned economy	Chinese model	Soviet model	Market economy
Decision-making	Centralised Direct means	Partially decentralised Mainly indirect means	Largely decentralised Indirect means	Decentralised Indirect means
Information	Vertical flow Non-monetary & partial monetary forms	Largely horizontal flow Mainly monetary forms	Horizontal flow Monetary forms	Horizontal flow Monetary forms
Motivation	All	Mainly material-oriented	Material-oriented	Material-oriented
Ownership	Non-individual	All	Largely individual	Individual

destination? As discussed in our analytical framework, various choices could be made in the proposals and blueprints of the reforms. In our case, four sides of the reform strategies applied are briefly compared. They involve the way to organise a reform process, the time length of completing the course, and the depth and the width of a reform intended.

6.3.1 Theory-led v. muddle-through

Examining the complete period of economic reform, it seemed obvious that the Soviet reformers preferred to work out the detailed and overall blueprints for guiding the implementation on one round of economic reform before any practical steps were taken. This was particularly true when one studied the two principal packages of economic reform blueprints in 1987 and 1990 and their implementations. No immediate and substantial action followed after the publication of the paper plans, not to say before the plans. It seemed that reformers in the Soviet economy were very much concerned with theoretical preparation for economic reform. However, the contradictions in ideas of economic transformation hampered the implementation of the proposals.

China's case was different. As it was famously stated by Deng Xiaoping himself, Chinese were "filling for stones while walking across the river". Designing a complete blueprint for reform did not receive much attention at least in the major stages of the process. One could not even call any reform proposal in one sector, not to say the whole economy, as a blueprint for operation, because in many cases the official documents only set the principles or approved relevant experiments to set an example. Piecemeal and specific plans prevailed and many of them were formed on the basis of summarizing of small scale experiment which took place almost without any detailed theoretical guidance. So muddle-through, just as Deng Xiaoping called it, was the

way of Chinese economic reform.

Nevertheless, neither in the Soviet theory-led nor in the Chinese muddle-through reform was there any sufficient theory of economics underpinning the reform proposals. If we ask, is there any school of economic theory which was accepted as the conceptual basis of a new type of economic system? The answer for both of our cases proved to be negative. The Soviet reform proposals were better organised in their shape, but the basis for transformation of a planned economy to a market one had been established on the simple belief that market mechanism would help to overcome the problems occurred in the planned economy. As pointed out in our Introduction (Chapter One), features of various models of a market economy were neglected here by the reformers. This was the theoretical background for the Chinese reform as well, though not exactly the same. This might explain some obvious conflicts embodied in the Soviet reform plans for changing the economic mechanisms even on the paper, let it alone in practice, whilst the Chinese reform also faced this kind of conflict amongst individual proposals.

Why did reformers in China and the Soviet Union take different ways to economic reform? To the Soviet Union where the history of running and modifying the centrally planned economy was much longer than in China, it might be recognised that piecemeal and small scale steps which did not require well-organised blueprints would no longer work efficiently in the late-1980s. Large scale effort must be attempted in order to be effective. For this sort of reform, delicate preparation in designs and plans seemed absolutely necessary. In addition, this work could be done by some outstanding Soviet economists because they have been well trained in a systematic way as the economists in a planned economy, though, and allowed to play a greater role in this field compared to their colleagues in China. This, however, does not imply

that the reform designs for the Soviet economy were superior than the Chinese ones in qualitative terms. In China's case, a muddle-through strategy was chosen due to the very fact that the reformers themselves did not well know, particularly at the beginning, where the reform would or should go and what ought to be done in order to reach to the intended end. They have been careful explorers in the sense that they preferred small scale trial for any intended reform action before approval for large scale implementation through formal reform decrees.

To say that the Soviets chose a theory-led strategy for carrying out the transformation is to state the fact that action of practical reform was not feasible before any proposal was officially released. While only discussions and debate on economic reform plans took place in the former Soviet Union, China marched forward, though slowly, steadily on the way of reform with or without well-prepared plans for the transformation. The political background behind the economic reforms in the two countries did contribute to the different strategies the reformers took. When anti-reform pressures were from below, muddle-through could not happen in the former Soviet Union, as was the case in China.

6.3.2 Revolution v. Evolution

The speed of implementing and completing one round of economic reform by plan showed a very sharp contrast between the Chinese and the Soviet experiences. There should be no dispute that Chinese reformers pursued a gradual progress. First of all, one might notice that the length of time for the critical blueprints to be worked out was shorter in the Soviet economy than in China's. In other words, proposal work was more time-consuming in China. This conclusion is also correct on the occasion of the time scheduled for completing the

implementation of the reform plans in the two economies. One may simply refer to the case of the 1990 Presidential reform plan in the Soviet Union which expected less than three years to build up the main frame of the Soviet-type market economy. On the same issue Chinese reformers repeatedly stress the longlasting endeavour to reach the aimed goal of restructuring which would alter less of the existing planned economy than the Soviet Union or Russia.

What factors set the timetables for implementing the reforms in the two countries? Are Chinese reformers, as is well-known, more patient than their Soviet colleagues? As a matter of fact, the hardship the Chinese economy faced in the late 1970s was severe and a fast-going change was necessary. The wave of reform at the initial stage of China's economic restructuring seemed to be leading this way. But the long term results showed the opposite. This analysis applies to the Soviet case in a contrary manner. The late process there experienced a very dramatic movement, not smoothly and continuously like in China. Here, political factors were obviously involved. In the Soviet Union where struggle against anti-reformers and conservatives had been bitter not only at the top leadership but also among the population, the reformers believed that for radical transformation to be successful, it should be implemented as quickly as possible.

There was also one factor which should play role in explaining the revolutionary progress in the Soviet reform proposals. As the original centrally planned economy in the world, the Soviet Union was a very late comer in the course of economic transformation. It thus gained the late-comer advantages² which enabled it to shorten the process of transforming the planned economy into a market-oriented one. For

² Late-comer advantages describe the fact that as a late-comer, it could avoid the unnecessary technical problems and difficulties encountered by the early comers and shorten the time to reach the same destination by learning and assessing the early-comers experiences and lessons (Gerschenkron, 1962).

example, the Soviet reformers could learn from the experiences of other socialist economies which began economic reforms much earlier than it. It could avoid the proven unnecessary mistakes in the course of the transition. In the meantime, Chinese reformers did have this advantage on many important issues when it began its design of the reform. Of course, other elements, such as the nationality characters and cultural background of the Russian(Soviet people) and the Chinese, also play a part here. It is very interesting to note that Russian communist revolution in 1917 took place and completed in a much shorter time than the Chinese one in 1949. It was very possible that the same difference occurred in the course of economic revolution, too.

In relation to the conclusion drawn in the previous section, it is interesting to notice that Soviet case is one of theory-led and revolutionary reform. What does it mean in our context? It may enable one to say that only theory-led reform can lead to the result of revolution, because the result can be achieved with a determined and well-planned goal. But theory-led reform may create an evolutionary transformation as well.

6.3.3 Comprehensive v. partial

To verify the width of the economic reforms by comprehensiveness or partiality in the two economies, the two reform packages in the Soviet case must be dealt with individually due to the sharp difference between them in this point. This policy applies to the reform proposals for some sectors and for the whole economy in China as well, though the situation there is not as sharp as it is in the Soviet economy.

China's economic reform of the rural economy involving the system of regulating the major aspects of production in this sector can be labelled, to a large extent, as the comprehensive process, if one can isolate it

from the rest of the national economy for the purpose of a theoretical analysis. At the same time, reform plans for other sectors and the economy as a whole seem not to cover the range which is wide enough to be comprehensive. Some issues in the economy are not touched on in the paper.

On the Soviet side, the label of comprehensiveness of a reform should be put on the 1987 reform package. While the 1990 reform plan showed its partiality for not providing or even mentioning some important issues relevant in the process of economic reform.

What one can say in general about the conclusion of a comparison between our two cases in their width of range? As far as the paper proposals were concerned, the Chinese reformers presented more comprehensive work in the whole period than their Soviet colleagues. The real situation in practice showed that economic reform in China involved massive spheres which were impressive on its wide range.

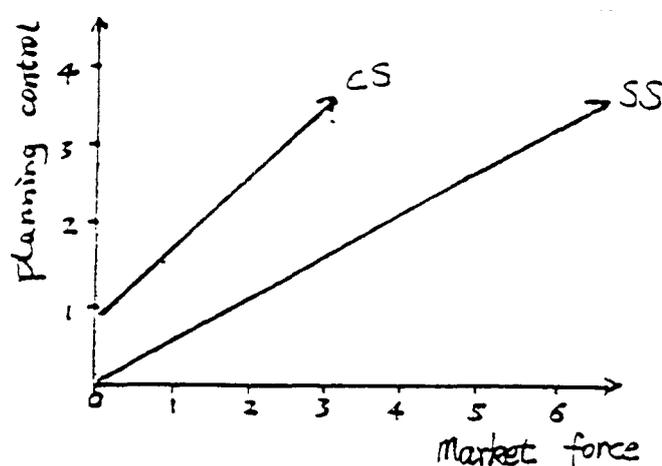
In theory the range of the reform proposals was supposed to have something to do with the theory-led style of carrying out a reform. Emphasising the theoretical designing of reform process makes it likely a comprehensive reform, compared to the case on the contrary. But our conclusion here revealed that it is possible for a comprehensive reform to occur without great attention on the well-organised paper plan. But it takes longer time to cover a wide enough range of the economic mechanisms by a muddle through method.

6.3.4 Radical v. moderate

Radical or moderate in the context of our discussion means the extent of the transformation of planned economy into a market-oriented economy. Radicalness is, therefore, measured by the degree of market

mechanism introduced into the prospective economy. Assessing the radicalness of economic reforms in our two cases in the first place we can use the information provided by the two panels, panel 4-4-2 and 5-4-2 in which the stages of transformations are analysed. By matching the two panels, the difference in depth of reforms in the two economies is approximately shown in Graphic 6-3-1.

Graphic 6-3-1 Depth of Reforms in China and the former Soviet Union



Sources: Panel 4.4.2 of chapter 4 and panel 5.4.2 of chapter 5.

Note: CS—Stage of China's reform

SS—Stage of Soviet reform

Certainly, the real world is not as simple as the curves indicate. For example, the two Soviet economic reform packages need to be considered individually, as they were in the previous section, when the comparison between the two countries are taken. To assess the radicalness of the Chinese reform, things are also slightly complicated. Because some parts of the proposals for reforming the planned system show their degree of depth, e.g. rural reform whereas the aggregate plan was more or less moderate.

By moderateness of the economic reform in China, we refer to the

comparison between the reform proposals in general in the Chinese economy and the reform plans of 1990s, the Presidential plan and Shatalin plan, in the Soviet case which were well-known for their radical tone. There shall be no argument that the 1987 reform package in the Soviet Union was of a moderate nature compared to the early appeals of economic reform in China, e.g. sectoral reforms proposed before 1984. As explained in Chapter Five, the later 1990 reform plan took more weight in the assessment of the depth of reform in the country. Therefore, on the final score of the paper plans, we should say that down the way of transition the Soviets lead.

Radicalness and moderateness of an economic reform in the CPEs was undoubtedly a result of the complex of political struggles among reformers and anti-reformers, further, among communist reformers and non-communist reformers in the Soviet case. A radical reform like approach to a private market economy must require a breakthrough of the official ideology. In China, where the communist party still holds on to its monopoly of power in the society, it is difficult for the reformers to abandon entirely the so-called socialist principles such as public (state) ownership.

The discussion of our cases above. revealed the significance of techniques required for economic transformation. Interesting patterns occurred in terms of techniques taken by different reform plans in our two countries. First of all, reform in China in general was a moderate, comprehensive, evolutionary and muddle-through one with some factors of radicalness in some sectoral reforms. In the meantime, the labels of radicalness, partiality, revolution and theory-led classified the Soviet reform, while the moderate 1987 reform package should not be ignored. This conclusion implies that, in the real cases, no definite interrelation could be traced between the depth and width of a reform, and the depth and speed of a reform. In other words, a radical reform is

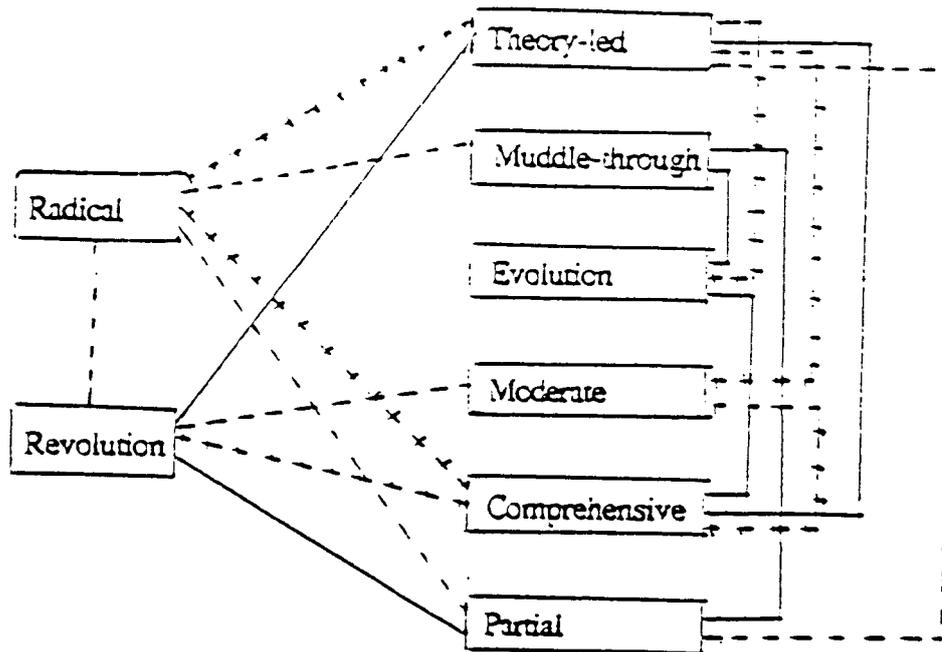
not necessarily to be a comprehensive one, and vice versa, like the case of 1990 reform plans in the Soviet economy and sectoral reforms in China. A radical reform need not be revolutionary, though it is likely to take place as a revolution, e.g. the rural reform in China and the 1990 reform plans in the Soviet Union.

Anyhow, some relations between the pairs of reform strategies may be drawn as in Panel 6-3-1. From it, one could say that a radical reform or transformation did not require any specific strategy to be successful. This left much room for reformers to choose the way for implementing a radical reform. Meanwhile, a revolutionary transformation asked much more for it to be successful. One of them was a well-designated paper plan. Otherwise it could go out of control. This primary conclusion was significant because it meant to reformers that a radical transformation could be completed in more than one way.

6.4. Some further concluding words

Up to now, we have compared from three perspectives the proposals of economic reforms in China and the former Soviet Union, the major issues of the reform, the changes proposed in terms of economic system theory and the strategies of the reform adopted in the two countries. Some conclusions were drawn according to each individual issue which would absolutely improve the understanding of the situation in the two countries in the first instance. Moreover, the experiences of China and the former Soviet Union in transforming the centrally planned economy could be valuable not only for country studies but also for theoretical constructions of economic system studies. Because a number of questions rather than resolutions have been put forward in terms of economic theory in the course of the economic transition in the two countries.

Panel 6-3-1 Relations between various strategies



Notes: ——— definite interrelation
 +++++ strong relation
 - - - - - weak relation

The comparison of economic transformations proposed in our two countries was impressive in a perspective of prospect of the transition in the former CPEs. It raised a number of questions that need to be discussed further. Here we may be able to touch very slightly on some of them, for which the answers remain to be seen. There are two groups of issues in relation to the proposals of economic transformations in our two countries that is of interest in this thesis. One is about the objective

models of the economic system intended by the reformers, the other is related with the ways the trans-formations are being achieved.

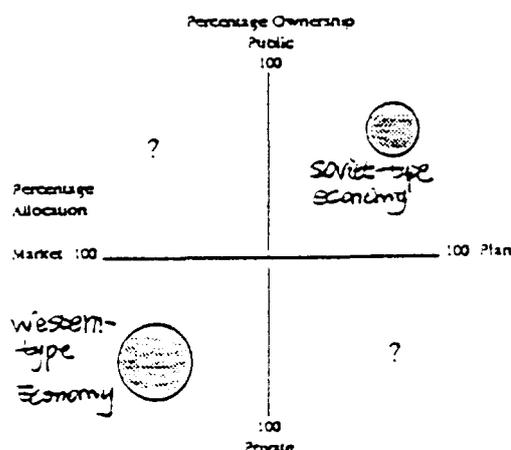
6.4.1 Issues of the objective models

The comparative study of the economic reform proposals in China and the former Soviet Union in 1980s and 1990s as conducted in the main theme of this thesis contributes not only to the country studies, but also to the theoretical construction of economics, particularly economic system studies. The similarities and differences in transformation of the centrally planned economies in our two countries, on the paper plan in the first place, raised a number of questions some of which challenged the mainstream economics.

The experience of Chinese economic reform raised a very interesting question: is non-individual ownership compatible with the market mechanism? Or, in general, can planned control be combined with a market economy? It is obvious that Chinese reformers challenged the longlasting debate of the “third way” of the economic reform by attempting to build up a “socialist market economy” which would locate it between the classic planned economy and a private market economy. One may ask whether the Chinese approach feasible and likely to be long lived?

According to the prevailing argument, with which the present author agrees, that the compromise between planned and market economies, or put it in another way, between socialism and capitalism, is not possible. It would only make things worse. “Market socialism” was described by Philip Hanson as “the Bermuda Triangle” (Hanson, 1991b). To him, it is obvious that public ownership is incompatible with the market mechanism (see Figure 6.4.1).

Figure 6.4.1. "The Bermuda Triangle"



Source: Hanson 1991b.

However, the destination of China's economic reform in the foreseeable future is the attempt to live in the triangle. The present author believed it would and could stay there for a long time. To explain the probably exceptional case of China, the fact that China is a developing country as well as a planned economy must be taken into consideration. In this kind of economy something which was assumed impossible in theory for West industrialised countries could be successful.

What is more important is that the purpose of economic reform in China was to improve the efficiency of the traditional planned economy, which was concerned mainly with economic issues. This made it unique in the course of its transformation from the former CPEs, including the former Soviet Union and the East European countries, in the sense that communist ideology remained as the official policy though it had been revised and relaxed in many aspects in relation to economic issues. Nevertheless, the state was still reluctant to give up its control over a large share of the national economy and massive privatisation was rejected despite rapid growth of non-state sector in the country. The ideal environment for a genuine market-oriented transition created by political revolution in the former Soviet

Union and the East European countries was not achieved in China. So the role of market mechanism in the prospective economy of China would depend on the tolerance of the communist regime.

In the former Soviet Union, or Russia for example, transition into a private market economy was a political matter as well as economic resolution. This also cast doubt on a well-organised and smooth transformation in the country in terms of technical arrangements, even if the reformers in the former Soviet Union knew better about their destination than their Chinese colleagues.

6.4.2 Technical constraints of the transition

Constraints and difficulties of the historical transition in the two countries were found first of all in the paper plans. A well-organised blueprint is the basic prerequisite for a successful transformation. However, this condition was not met satisfactorily in our two countries. Firstly, the proposals of reforms including official plans for operation did not provide sufficient details and the necessary techniques for how the implementation would be realised. General tones and principles were the characteristics of the proposals. It was difficult for the reformers in either China or the Soviet Union to meet this requirement because, on the one hand, as noted in our earlier discussion in this section, they themselves were not clear in theory where they would lead the reform to and what the destination would look like. On the other hand, even if they knew the end point of the reform, (e.g. it could be a kind of market economy), it would still be a hard job for them to design a proper plan for the transition since their knowledge of market economics was limited in both theory and practice. They were learners rather than masters in this respect. The fact the more radical tones for transition to a market economy the less detailed arrangement of restructuring provided by the reform plans in our two cases verified

this assumption. Because the reformers could arrange less of a completely new type of economy which they had little knowledge than a plan-oriented destination. The obvious conflicts in the proposals about the sequence of the reform could be attributable to this sort of reason.

Secondly, if the end point was clear, it would be necessary for the reformers to set the list of things that must be done in order to reach the destination. This was also not an easy job. There had been various suggestions for what to do in the transition from the centrally planned economy to a market economy, and the reformers had to judge and make their own decisions, although some of the key issues were commonly agreed as the necessary ingredients of the package of a market-oriented transformation (Farrell, 1991). After setting the list of things to do, the immediate question is what must be first done? The transition must be a complex of changes of numerous interrelated parts of the economy which require to be achieved at the same time, otherwise it could only make things worse. As a matter of fact, no reform could be implemented at one stroke on all the essential issues. The problem, and the dilemma, of sequencing of the transition occurred. Furthermore, the prediction of the possible problems and consequences that would occur in the course of transformation was also one of the crucial requirements for the reform planners when they worked out the operational blueprint of the reform.

What made things more complex in the context of economic reform in the former CPEs is that the reform had never been solely the matter of economics. The transition to a market-oriented economy would cause fundamental change of the whole society which would make the changes of constitutional, political, social and moral structures inevitable. The transformation process would, therefore, be unpredictable and uncertain. In this process China and the former Soviet Union felt extraordinarily hard compared with the East European countries

because, as was already pointed out, there was little democratic tradition politically, nor a sound market economy in the two countries before the communist revolution that could be restored. This was especially true of the Soviet case.

Last but not least, although the economic reforms in the former CPEs have entered a new era of fundamentally switching off the classic planned economy, there is a long way for them to go to the intended destination, if there is such one as they hoped for. It is, therefore, necessary for further study of the semi-reformed planned economy, or whatever people may label it, which would be different in operating principles from either the classic planned economy or a market economy. The tools provided by the socialist economics (Marxian economics) are out of date, and the mainstream economics in market economy are yet insufficient. This thesis is one of the efforts to contribute to the progress of the economic analysis of the former CPEs. But it is only one of the exploring ones. And there is, of course, a lot more work remaining to be done in this field.

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NUMBERING

AS ORIGINAL

Appendix I

Accelerating Reform and Opening-Up

Following is the full text of the report delivered October 12, 1992 by Jiang Zemin, general secretary of the Central Committee of the Chinese Communist Party, at the 14th National Congress of the Party. The report is entitled "Accelerating the Reform, the Opening to the Outside World and the Drive for Modernization, so as to Achieve Greater Successes in Building Socialism With Chinese Characteristics."

(Beijing Review. Vol.35, No.43, Oct.26, 1992.)



Comrades,

The 14th National Congress of the Communist Party of China has been convened in a new situation in which our country is accelerating its reform, its opening to the outside world and its drive for modernization. Now, I should like to present a report to the congress on behalf of the 13th Central Committee.

This congress has a historic mission to fulfil. The members of the Party and the people of different nationalities throughout China all have great hopes for it, and our friends in other countries who care about China are also paying close attention to its proceedings. We are convinced that if all deputies work to make it so, this will be a united and successful congress.

Since the Third Plenary Session of the 11th Central Committee, the Party and the people, guided by the theory of building socialism with Chinese characteristics put forward by Comrade Deng Xiaoping, have been working hard to carry out reform. The whole nation has been reinvigorated, and historic changes have taken place across the land. The productive forces have been further emancipated, and the political situation of stability and unity has been steadily consolidated. The 1.1 billion people of China, with their basic needs assured, are moving towards a rela-

tively comfortable standard of living. We have made major progress in developing the economy, improving the people's living standards and increasing the overall strength of the country. China's socialist system has withstood severe tests and shown great vitality in the face of drastic changes in the world situation.

The important talks given by Comrade Deng Xiaoping when he visited the south early this year have been a great encouragement to members of the Party and to the people of all China's nationalities. The cadres and the masses have further emancipated their minds and are full of enthusiasm. Leaders and people are united, and the whole country is seething with activity, giving promise of a wonderful future in which the Chinese nation will have realized its lofty ideals.

The 13th Central Committee has made an overall analysis of the current situation. It has agreed unanimously that domestic conditions are ripe for faster development, that the international environment is favourable for it, and that while the present moment poses challenges, it also presents opportunities for us to accelerate our advance. The tasks of this congress are, under the guidance of Comrade Deng Xiaoping's theory of building socialism with Chinese characteristics, to review the practical experience of the 14 years since the Third Plenary Session of the 11th Central Committee and to formulate a strategic plan for the next period. It is also the task of the congress to mobilize all Party comrades and the people of all nationalities to achieve still greater successes in building socialism with Chinese characteristics by further emancipating their minds and seizing this opportune moment to quicken the pace of the reform, the opening to the outside world and the drive for modernization.

I. General Summary of the Great Practice of the Last 14 Years

In the last 14 years, adhering to the basic line of the Party, we have been building socialism with Chinese characteristics through reform and the opening to the outside world and through the liberation and development of the productive forces. In view of the deep and widespread social changes that have taken place, we can truly say that we have begun a new revolution, the objective of which is to fundamentally change the economic structure that has hampered the development of the productive forces and to establish a new and vigorous socialist economic structure. At the same time, we have been carrying out a corresponding reform of political and other structures, in order to realize the socialist moderniza-

tion of China.

In the history of our Party, the first generation of central leadership, with Comrade Mao Zedong at the core, led the whole Party and the people of all nationalities first in the long, triumphant struggle to make the new-democratic revolution and then in the effort to establish the basic system of socialism and to liberate and develop the productive forces. The semi-colonial and semi-feudal China of the past, which for over a hundred years had suffered from foreign aggression and bullying, was turned into a new and independent socialist China in which the people were the masters. This revolution, the greatest China had ever seen, ushered in a new era in the history of our country.

The second generation of the central leadership, with Comrade Deng Xiaoping at the core, has led the whole Party and the people of all nationalities in another great revolution, the goal of which is to further liberate and develop the productive forces. This new revolution is designed to turn our underdeveloped socialist country into a prosperous, strong, democratic, culturally advanced and modern socialist country, so as to fully demonstrate the superiority of socialism in China. It is based on our earlier revolutionary victory and on our great achievements in socialist construction, and it is being carried out step by step, in good order, under the leadership of the Party. This revolution is not intended to change the nature of our socialist system but to improve and develop it. It is no minor patching-up of the economic structure but a fundamental restructuring of the economy. The old economic structure has its historical origins and has played an important and positive role. With changing conditions, however, it has come to correspond less and less to the requirements of the modernization programme. The most profound change brought about by the reform in the last 14 years is that many ideological and structural shackles have been shaken off. This has released the initiative of the masses, so that China, with its 1.1 billion people, is now creating a vigorous socialism.

At the present national congress, it is essential to review the great practice of the people under the leadership of the Party over the past 14 years and to draw careful conclusions about the basic theory, the basic line and the strategic policy decisions formulated by the Party in the course of that practice. This is of vital present and long-term importance to the unification of the thinking of all Party members, the application of the Party's basic theory, the adherence to its basic line and the advance of the great cause of building socialism with Chinese characteristics.

We all remember that the toppling of the "gang of four" saved the Party and the country from disaster, but the political, ideological, organizational and economic chaos left over from the "cultural revolution" was still a very serious problem. At that time it was by no means easy to extricate ourselves from the predicament and bring about a new situation. The Third Plenary Session of the 11th Central Committee, held in 1978, and the central leadership formed at that session with Comrade Deng Xiaoping at the core, took up this difficult mission, accomplished the historic change and launched a new era in the development of our socialist cause.

Around the time of that session, our Party encouraged and guided a major debate on the proposition that practice is the sole criterion for judging truth. This debate shattered the personality cult and the doctrine of the "two whatevers" [the notion that after the death of Chairman Mao Zedong, whatever policy decisions he had made must be firmly upheld and whatever instructions he had given must be followed unswervingly — *Tr.*] and reaffirmed the ideological line of emancipating the mind and seeking truth from facts. This represented our rectification of the ideological line.

At the Third Plenary Session of the 11th Central Committee, our Party abandoned the wrong, "Left" principle of "taking class struggle as the key link," which was not appropriate in a socialist society, and shifted the focus of work of the Party and the state onto economic development. This represented our rectification of the political line. At the same time, the Central Committee made a major policy decision: to undertake reform and to open China to the outside world. To counter the wrong ideological trends that had manifested themselves in the preceding period, it stated unequivocally that we must keep to the socialist road and adhere to the people's democratic dictatorship, to leadership by the Communist Party of China and to Marxism-Leninism and Mao Zedong Thought. [These are known as the Four Cardinal Principles. — *Tr.*] The idea of "one central task, two basic points" began to take shape as the foundation for the Party's basic line in the new period.

The Party emphasized that the only way to ensure the implementation of the correct ideological and political lines was to have a correct organizational line. It recognized that as required at this historic turning point, we had to strengthen the organization of the Party by gradually adjusting and consolidating leadership at different levels. We were to accomplish this by making the ranks of cadres more revolutionary, younger,

better educated and more professionally competent, by doing away with *de facto* life tenure for leading cadres, and by encouraging co-operation between young and old cadres and gradually replacing the old with the young.

The Party also straightened out certain major historical issues of right and wrong. A series of measures were taken to redress individual injustices, and various policies were carried out to strengthen Party unity and mobilize all positive forces. At its Sixth Plenary Session the 11th Central Committee adopted a resolution on certain questions in the history of the Party since the founding of the People's Republic. In that resolution it fundamentally condemned the "cultural revolution" and rejected the theory of "continued revolution under the dictatorship of the proletariat." At the same time, it came out strongly against the wrong ideological tendency to deny the value of Comrade Mao Zedong's work and Mao Zedong Thought altogether, maintained the importance of the role Comrade Mao had played in Chinese history and reaffirmed the value of Mao Zedong Thought as a guide to action. As the domestic situation develops and the international situation changes, the courage and far-sightedness of the Party in adopting this momentous resolution are becoming more and more apparent.

Having rectified the erroneous ideological and political lines, the Party convened its 12th National Congress in 1982. The congress put forward the idea of "integrating the universal truth of Marxism with the concrete practice of China, blazing a path of our own and building socialism with Chinese characteristics" and set the target of quadrupling the gross national product by the end of the century, in two stages. Later, the Party proposed that, in a third stage, socialist modernization should be basically accomplished by the middle of the next century. By setting these great goals, the Party is leading the people of all our nationalities forward into the 21st century.

The dominant feature of the new period is the policy of reform and opening to the outside world, which was initiated at the Third Plenary Session of the 11th Central Committee and which has been carried out in every area ever since the 12th National Party Congress. The reform has surged from the countryside to the cities, from the economic structure to other structures and from the revitalization of the domestic economy to the opening to the outside world.

The strategic decision to start the reform in the rural areas was in conformity with the realities in China. The household contract responsibility system with remuneration linked to output was a great innovation of the Chinese peasants. The

Central Committee of the Party respected the wishes of the masses and actively supported the experiment, which in a few years was spread throughout the country. A major problem in the structure of the socialist rural economy was solved by dismantling the people's communes without privatizing ownership of the land and by introducing the household contract responsibility system supplemented by unified management. In this way, the 800 million peasants have gained the power to make their own decisions about production. In addition, we almost entirely did away with the unified purchase of farm products by the state according to fixed quotas and lifted price controls over most of them, thus helping agricultural production break out of its long-term stagnation. The rural economy rapidly became specialized, commercialized and socialized. People in both rural and urban areas have enjoyed tangible benefits from this, and it has given impetus to all our undertakings in reform and economic development. Township enterprises, another great innovation of the Chinese peasants, have expanded enormously. They have created a new outlet for surplus labour on the land, a new way for rural people to become prosperous and to modernize the countryside, and a new means of promoting the reform and development of industry and of the economy as a whole.

In accordance with the new situation in which reform had been introduced first in the countryside, then in the cities and towns, the Third Plenary Session of the 12th Central Committee adopted a resolution on economic restructuring. It declared that our socialist economy was a planned commodity economy based on public ownership and rejected the traditional concept that a planned economy was in direct opposition to a commodity economy. This represented a new development of Marxist theory on political economy and provided a new theoretical guide for overall reform of the economic structure. Later, the Party decided to reform the management systems of science and technology and of education, and it set the objectives and tasks for the reform of the political structure.

The establishment of the four special economic zones of Shenzhen, Zhuhai, Shantou and Xiamen was an important step in opening China to the outside world and a new experiment in utilizing foreign funds, technology and managerial skills to develop the socialist economy. Great achievements have already been scored in these zones. Facts have demonstrated that they are socialist, not capitalist, in nature. Later, more than a dozen coastal cities were opened, as were economic areas in the Yangtze River Delta, the Pearl River Delta

and southeastern Fujian and around the perimeter of Bohai Bay. Also, Hainan Island was authorized to become a province and later a special economic zone. The number of areas that have been opened to the rest of the world has been continually increased. The coastal areas, with 200 million inhabitants, have thrived rapidly, giving great impetus to the reform, the opening up and economic development in the country as a whole.

If reform and economic development are to proceed smoothly, they must have powerful ideological and political guarantees. The Party has put forward the strategic principle of "grasping two links at the same time." By this it means that we should pursue the process of reform and opening up and at the same time fight crime, that we should develop the economy and at the same time strengthen democracy and the legal system, that we should achieve material progress and at the same time foster an advanced culture and ideology. In particular, the Sixth Plenary Session of the 12th Central Committee adopted a resolution declaring that our ideology must contribute to socialist modernization, promote the all-round reform and opening up and be based on adherence to the Four Cardinal Principles. The Party also stressed that we must explain to the people the need for continued struggle against bourgeois liberalization throughout the process of socialist modernization.

The 13th National Congress of the Party was convened in 1987. Its historic contributions were to expound in a systematic way the theory of the primary stage of socialism in China and to elaborate the Party's basic line, describing it concisely as "one central task, two basic points." [The central task was economic development; the two basic points were adherence to the Four Cardinal Principles and implementation of reform and the open policy. — *Tr.*] The congress attached immense significance to the fact that following the Third Plenary Session of the 11th Central Committee a way was found to build socialism with Chinese characteristics. It declared that this was the second historic leap forward in integrating Marxism with Chinese practice, the first having been the new-democratic revolution.

In the five years since the Party's 13th National Congress, we have continued our march along the road to socialism with Chinese characteristics. Under complicated and difficult conditions both at home and abroad, the Party has united and led the people of all our nationalities in an endeavour to surmount difficulties and achieve social and political stability and economic development.

The years from 1984 to 1988 were a period of accelerated expansion for the Chinese economy.

In agriculture and industry, in rural areas and cities, in reform and development, progress in one sector reinforced progress in another, and the economy as a whole was raised to a new level. However, during this period of rapid advance some problems arose: in particular, price rises were a little too sharp, and many construction projects were redundant. The Party therefore decided to spend some time improving the economic environment and rectifying the economic order to facilitate reform and development.

In late spring and early summer of 1989, a political disturbance broke out, and the Party and the government, relying on the people, took a clear-cut stand against unrest. They quelled the counter-revolutionary violence in Beijing, defending the power of the socialist state and the fundamental interests of the people and ensuring the continued progress of reform, the opening up and modernization. At the same time, the Central Committee explicitly proclaimed that the Party's basic line and the policy decisions made by the Thirteenth National Congress were correct and that we should not waver in our adherence to them because of this political disturbance.

The Fourth Plenary Session of the Thirteenth Central Committee elected a new central leadership. That leadership adhered to the Party's basic line in all fields of endeavour. It continued to make economic development the central task, while trying to rectify the overemphasis of material progress to the neglect of ideological progress by strengthening ideological and political work and the building of the Party. In the face of dramatic changes in the international situation, the Party remained calm and concentrated its attention on domestic affairs while keeping an eye on developments abroad. It adopted resolutions on a number of subjects: on strengthening clean government, on further improving the economic environment, rectifying the economic order and deepening the reform, on cementing the ties between the Party and the masses, on developing and opening the Pudong Area of Shanghai, on its proposals for the ten-year programme for national economic and social development and the Eighth Five-Year Plan, on improving the large and medium-sized state-owned enterprises and on strengthening agriculture and the Party's work in the rural areas. These major policy decisions made by the Party during a critical period of history were absolutely correct.

Early this year, during an inspection tour of the south, Comrade Deng Xiaoping gave several important talks. He made a penetrating analysis of the current international and domestic situation. He also made a scientific summation of the basic

practice and experience of the Party since the Third Plenary Session of the 11th Central Committee, clearing up many important misconceptions that had perplexed us and shackled our thinking over the past few years. He emphasized that the basic line must be followed unswervingly for 100 years. He urged us to further emancipate our minds, to be more daring in reform and opening up, to quicken the pace of economic development and not to lose any favourable opportunity.

Last March the Political Bureau of the Central Committee held a plenary meeting at which full agreement was reached on these talks given by Comrade Deng Xiaoping. The Political Bureau stated that they would not only serve as an important guide for our current efforts in reform and economic development and for the work of the present congress, but that they would also have far-reaching significance for the entire drive for socialist modernization. Since that meeting, the Central Committee and the State Council have made a series of decisions on ways to accelerate the reform, the opening up and economic development. The talks by Comrade Deng Xiaoping and the plenary meeting of the Political Bureau mark a new stage in China's reform and opening up and in its modernization drive.

Looking back on the road we have traversed in the past 14 years, we can see that there have been failings and mistakes in our work. There are still many difficulties to be overcome and many problems to be solved, and the people still have complaints about certain aspects of our work. But on the whole, it is generally acknowledged in the Party and the country that in these fourteen years we have truly concentrated on socialist modernization, rapidly improving the people's standard of living, bringing about a new situation, and scoring achievements that have attracted world attention. The Party has won the support of the people.

The fundamental reason our Party was able to accomplish so much in fourteen years is that it has persisted in integrating the basic tenets of Marxism with the concrete practice of China and has gradually formulated the theory of building socialism with Chinese characteristics. During the century and a half since the publication of *The Communist Manifesto*, the victories of the Russian October Revolution, the Chinese revolution and the revolutions in other countries have shown that with the leadership of the proletariat the people can indeed seize political power. Tremendous achievements have been scored, and much has been learned about how to build socialism. Nevertheless, the question still needs further exploration. Indeed, in view of the drastic changes

that have taken place internationally in recent years, it calls for profound study.

The Chinese Communist Party has always held that countries must maintain their independence in revolution and development and that the success of socialism in China depends essentially on ourselves, on the Chinese Party's theory and line, and on the united efforts of the Party and the people. The new developments in China and the achievements of socialism over the last 14 years have led us to compare our present with our past and our country with other countries. These comparisons have convinced us that our Party's theory of building socialism with Chinese characteristics is correct and that it corresponds to the interests and needs of the people. In formulating this theory, the Party has for the first time given preliminary but systematic answers to a series of basic questions about how to build, consolidate and develop socialism in a country with a backward economy and culture like China. It has also developed Marxism by introducing new ideas and viewpoints.

The main contents of the theory of building socialism with Chinese characteristics are as follows:

The road to socialism. We must take our own road, not regard books as dogma and not copy the models of other countries. We must take Marxism as a guide to action, make practice the only test for truth, emancipate our minds, seek truth from facts, value the initiative of the masses and build a socialism with Chinese characteristics.

The development of socialism in stages. According to our scientific thesis, China is still in the primary stage of socialism, which will last for at least a hundred years. All principles and policies must be based on this fundamental reality. We must not divorce ourselves from it or try to skip this stage.

The fundamental task of socialism. In essence, the objective of socialism is to liberate and develop the productive forces, to eliminate exploitation and polarization, and ultimately to achieve common prosperity. The principal contradiction in Chinese society in the present stage is the one between the growing material and cultural needs of the people and the backwardness of production. Accordingly, to promote the all-round progress of society, we must give priority to the growth of the productive forces and make economic development our central task. In the final analysis, the criterion for judging the success or failure of our work in various fields is whether it helps develop the productive forces of socialist society, strengthen the overall capacity of the country and improve the people's living stan-

dards. Science and technology constitute a primary productive force, and in pursuing economic development we must rely on scientific and technological progress and try to create a more highly skilled workforce.

The motive force of socialist development. Reform is also a revolution, a revolution whose goal is to liberate the productive forces. It is the only way to modernize China. If we cling to outmoded ideas and remain content with the status quo, we shall accomplish nothing. The objective of economic restructuring is to develop a socialist market economy, keeping the public sector as the dominant one and remuneration according to one's work as the principal mode of distribution, supplemented by other sectors and other modes. The objective of political restructuring is mainly to improve the system of people's congresses and the practice of multiparty cooperation and consultation under the leadership of the Communist Party and to develop socialist democracy. In correspondence with the economic and political restructuring, we must build an advanced socialist culture and ideology and develop a citizenry who have high ideals, moral integrity, a better education and a strong sense of discipline.

External conditions for socialist construction. The questions of peace and development are the two top priorities on the international agenda. We must adhere to an independent foreign policy of peace and try to create a favourable international environment for our modernization drive. It is essential for us to open to the outside world. This is indispensable to the reform and to economic development. We should also develop socialism by absorbing and utilizing the advances made by all other countries, including the developed capitalist countries. A closed-door policy can only perpetuate backwardness.

The political guarantee for socialist construction. We must keep to the socialist road and uphold the people's democratic dictatorship, leadership by the Chinese Communist Party and Marxism-Leninism and Mao Zedong Thought. These Four Cardinal Principles are the foundation of the country. It is these principles that will guarantee the sound development of the reform, the process of opening up and the drive for modernization, which will in turn enrich the principles with contemporary content.

The strategic plan for socialist construction. Modernization should be realized in three stages. In this long process we should seize all opportunities to bring about every few years a period of particularly rapid development and good economic results. Poverty is not socialism, but it is impossible for everyone to become prosperous

simultaneously. We must allow and encourage some areas and individuals to grow rich first, so that more and more areas and individuals will do so until common prosperity is eventually achieved.

Forces that lead in building socialism and forces that are relied on. The Chinese Communist Party, as the vanguard of the working class, is the force at the core leading the socialist cause forward. It must meet the requirements of the reform, the opening up and the modernization drive by constantly improving itself and strengthening its leadership in different areas of work. The style of work of a party in power and its links with the people are vital to its very existence. We must rely on the workers, peasants and intellectuals, on the unity of the people of various nationalities, and on the broadest possible united front of socialist workers, patriots who support socialism and patriots who desire the reunification of the motherland. The people's armed forces, led by the Party, are the defenders of the socialist motherland and an important force for building socialism.

Reunification of the motherland. We have put forward the creative concept of "one country, two systems" — the proposition that, on the premise that there is only one China, for a long time to come the main part of the country should adhere to the socialist system while Hong Kong, Macao and Taiwan maintain their original capitalist system. In accordance with this principle, we shall work for the peaceful reunification of the motherland.

The theory of building socialism with Chinese characteristics contains many other ideas. As we test it in the course of practice, study new situations and solve new problems, we shall continue to enrich, refine and develop it.

Under the guidance of this theory, our Party has formulated the basic line for the primary stage of socialism: to lead the people of all our nationalities in a united, self-reliant, intensive and pioneering effort to turn China into a prosperous, strong, democratic, culturally advanced and modern socialist country by making economic development our central task while adhering to the Four Cardinal Principles and persevering in reform and the open policy. "One central task, two basic points" is a succinct summarization of this line. To carry it out, our Party has also formulated a set of principles and policies regarding economics, politics, science and technology, education, culture and military and foreign affairs. This line and these principles and policies are likewise to be continually enriched, refined and developed in the course of practice.

The theory of building socialism with Chinese characteristics has taken shape gradually in the current situation in which peace and development are the priorities of the times, and as we have been carrying out reform and the open policy and bringing about socialist modernization. It has been based on a review of the experience gained from our successes and failures in building socialism in China and from those in other countries. It is the product of the integration of the fundamental tenets of Marxism-Leninism with the reality of present-day China and the special features of our times, a continuation and development of Mao Zedong Thought, a crystallization of the collective wisdom of the entire Party membership and the whole Chinese people, and an intellectual treasure belonging to them all.

Comrade Deng Xiaoping is the chief architect of our socialist reform, of the open policy and of the modernization programme. He respects practice and the masses and pays constant attention to the interests and aspirations of the majority of the people. He is adept at generalizing from their experiences and innovations, and he can sense the direction in which things are moving and seize upon favourable opportunities whenever they present themselves. He has carried forward the fine work of our predecessors, and at the same time he has broken with outmoded conventions, displaying his great political courage by blazing a new path to socialism and his great theoretical courage by opening new perspectives for Marxism. He has made historic contributions by formulating the theory of building socialism with Chinese characteristics.

The experiences drawn from practice over the past 14 years can be summed up in one sentence: We must firmly adhere to the Party's basic line, guided by the theory of building socialism with Chinese characteristics. This is the best way to ensure that we shall stand the test of the dangers we may face on the way to our goal.

To adhere to the Party's basic line, we must, first and foremost, persevere in economic development as our central task. Because of both domestic and international factors, even after the establishment of the basic socialist system, class struggle will continue to exist in some areas for a long time and may be intensified under certain circumstances. We must have a clear understanding of this question and handle correctly any problems that may arise. However, class struggle is no longer the principal contradiction in our society, and economic development has become our central task. We must never waver in it, except in case of a large-scale foreign invasion. In years past we sometimes turned aside from eco-

conomic development, because we did not have a clear understanding of certain international and domestic events. That was a serious mistake. Over the past 14 years, however, we have never been distracted from this central task, despite the major events of one kind or another that have taken place in China and abroad. We should continue to concentrate on it unremittingly in the years to come.

To adhere to the Party's basic line, we must integrate reform and the open policy with the Four Cardinal Principles. It is because we introduced reform and the open policy that socialism with Chinese characteristics is so vigorous today. And it is because reform and the open policy help consolidate and expand socialism that they have been progressing smoothly. The purpose of adhering to the Four Cardinal Principles and persevering in reform and the open policy is to liberate and develop the productive forces to an even greater extent. As we proceed, Party members, leading cadres in particular, must be on the alert for Right tendencies, but also and mainly for "Left" tendencies. Right tendencies are manifested chiefly in negating the Four Cardinal Principles, in pursuing bourgeois liberalization and sometimes in creating political turmoil. "Left" tendencies are manifested chiefly in denying the correctness of the reform and the open policy, maintaining that the main danger of peaceful evolution toward capitalism comes from the economic sphere, and trying to distract us from the central task of economic development by emphasizing the need for class struggle. Right tendencies can be the ruin of socialism, and so can "Left" tendencies.

"Left" ideas have deep roots in the history of our Party. Their exponents sound very revolutionary; they try to intimidate people by pinning political labels on them, as if being more "Left" meant being more revolutionary. Most of the mistakes that were made in the course of building socialism during the 20 years beginning in 1957 were "Left" in nature. It is likewise "Left" tendencies that present the chief obstacle to our efforts to explore a new path for reform and the open policy and to break out of the structures and conventions that hamper the development of the productive forces. Now we are making it clear that we must guard against Right tendencies but also and mainly against "Left" tendencies, in order that all our Party comrades, leading cadres in particular, will learn a profound lesson from the past and apply it to the present realities and to their own thoughts and work. This will help them enhance their political consciousness and their determination to carry out the Party's basic line,

to emancipate their minds and to work together for still greater successes in economic development and other undertakings. When there are problems of understanding, differing opinions and mistakes in practical work, we should analyse each of them realistically, and not arbitrarily describe them as "Left" or Right political tendencies.

To adhere to the Party's basic line, we must consolidate and expand political unity and stability. Without political and social stability, any attempt to carry out reform and the open policy and to promote economic development would be out of the question. We must adhere to the Four Cardinal Principles and resolutely eliminate all factors that might lead to unrest or turmoil in China. Conversely, if we do not take economic development as our central task and carry out reform and the open policy, and if we therefore fail to achieve economic growth, any effort to consolidate unity and stability would be out of the question. Only so long as the basic line remains unchanged and there is social and political stability shall we be able to forge ahead steadily.

II. The Major Tasks in the Reform and Economic Development in the 1990s

The key to advancing the building of socialism with Chinese characteristics is to adhere to the Party's basic line, accelerating the reform and the opening to the outside world and concentrating on economic development. At the same time, while making economic development our central task, we should also improve our socialist democracy, legal system, culture and ethics, so as to ensure all-round social progress.

Modern Chinese history and the realities of the present-day world show that so long as a country is economically backward, it will be in a passive position, subject to manipulation by others. Nowadays the competition among the various countries is, in essence, a competition of overall national strength based on economic, scientific and technological strength. A great number of countries and regions, especially our neighbours, are speeding up their development. If we fail to develop our economy rapidly, it will be very difficult for us to consolidate the socialist system and maintain long-term social stability. Whether we can accelerate economic growth is therefore an important question both economically and politically.

The economic target set for the 1990s was to increase the gross national product annually by 6 per cent. However, judging from the situation at home and abroad, it is possible for us to achieve

a higher growth rate. According to an initial estimate, we can achieve a growth rate of 8 or 9 per cent, and we should strive to do so. If we work hard to improve the quality of products and to optimize the structure of production and increase economic returns, we should be able to attain that goal. Then, by the end of this century, overall economic performance will have improved, the overall national strength will have been raised to a new level, the output of the basic industrial and agricultural products will have greatly increased and we shall have exceeded the goal of quadrupling the GNP of 1980. The structure of production and the regional distribution of the economy will have become more rational, and scientific and technological levels and managerial skills will have been raised considerably. A large number of key enterprises will have reached or approached advanced world standards. The people will be beginning to lead a relatively comfortable life. We propose that the State Council readjust the Eighth Five-Year Plan in accordance with the estimated higher growth rate and begin drawing up the ninth.

We should seize the present opportunity to accelerate economic development. In areas where conditions permit, we should do our best to achieve a higher rate of growth. We should encourage expanded production by enterprises that can turn out high-quality products, operate efficiently and satisfy the changing needs of markets both at home and abroad. At the same time, we should proceed from actual conditions, keep development within the limits of our capabilities and maintain an overall balance. In our efforts to speed up economic growth, we should avoid the mistakes of the past. We should not rush headlong into action, neglecting economic results, vying with each other in pursuit of a higher growth rate and seeking only increased output value, new construction projects and expanded capital construction. We should do solid work, proceeding boldly but prudently and making concerted efforts to accomplish a few major tasks that will pave the way for faster growth and better economic results in future.

To accelerate economic growth we must further emancipate our minds, speed up the reform and the opening to the rest of the world and not get bogged down in an abstract debate over what is socialist and what is capitalist. To achieve superiority over capitalist countries, socialist countries should not hesitate to adopt from abroad, including from the developed capitalist countries, any advanced methods of operation or management techniques that reflect the general laws governing modern production and the commodity economy.

Foreign funds, resources, technology and skilled personnel, along with privately owned enterprises that are a useful supplement to our economy, can and should be put to use for the benefit of socialism. That will not harm socialism but help it, since political power is in the hands of the people, and since we have a strong public sector.

Setting the right objective for the reform of China's economic structure is vital to the success of the drive for socialist modernization. Correct understanding and handling of the relations between planning and market regulation is crucial. According to conventional thinking, a market economy is peculiar to capitalism, and a planned economy is the basic feature of socialism. Since the Third Plenary Session of the 11th Central Committee and with the deepening of the reform, we have gradually freed ourselves from those conventional ideas and acquired a new understanding of this question. This has played an important role in advancing the reform and economic development. The 12th National Congress declared that in a socialist economy planning was primary and market regulation secondary. At the Third Plenary Session of the 12th Central Committee, the Party stated that a commodity economy was a stage that could not be bypassed in socio-economic development and that China's socialist economy was a planned commodity economy based on public ownership. The 13th National Congress held that the socialist planned commodity economy should be a system that integrated planning with market regulation. After the Fourth Plenary Session of the 13th Central Committee it said that to facilitate the development of a socialist planned commodity economy, we should establish an economic structure and an operating mechanism that combined planning with the use of market forces.

In the important talks he gave earlier this year, Comrade Deng Xiaoping particularly pointed out that a planned economy was not socialism — there was planning under capitalism too. A market economy was not capitalism — there was market regulation under socialism too. Planning and market regulation, he said, were both means of controlling economic activity. Whether the emphasis was on planning or on market regulation was not the essential distinction between socialism and capitalism. This brilliant thesis has helped free us from the restrictive notion that the planned economy and the market economy belong to basically different social systems, thus bringing about a great breakthrough in our understanding of the relations between planning and market regulation.

With the reform and the open policy introd-

uced in the last dozen years, market forces have functioned more extensively. Control over the prices of most commodities has been relaxed and the extent of mandatory planning considerably reduced, which has given greater scope to market forces in regulating economic activities. Practice in China has proved that where market forces have been given full play, there the economy has been vigorous and has developed in a sound way. To optimize the economic structure, to improve economic performance, to accelerate economic development and to take part in international competition, we must continue to intensify the market forces. Now that we have gained a deeper understanding of them in practice, we should state explicitly that the objective of the reform of the economic structure will be to establish a socialist market economy that will further liberate and expand the productive forces.

By establishing such an economic structure we mean to let market forces, under the macro-economic control of the state, serve as the basic means of regulating the allocation of resources, to subject economic activity to the law of value and to make it responsive to the changing relations between supply and demand. We should make use of pricing and competition to distribute resources to those enterprises that yield good economic returns. In this way, we shall provide an incentive for enterprises to improve their performance, so that the efficient ones will prosper and the inefficient ones will be eliminated.

Since the market is sensitive to changes in demand, we should use it to make timely readjustment in production, as necessary. Nevertheless, we must be aware that the market has its own weaknesses and negative aspects. Macro-control of the economy by the state is therefore very important, and the way in which it is exercised must be improved. We should work hard to establish an integrated national market, and we should give more rein to market forces. We should guide the growth of the market by economic policies, regulations, planning and necessary administrative means, in accordance with objective laws.

The socialist market economy is a component part of the basic system of socialism. So far as the ownership structure is concerned, for a long time to come we should allow diverse sectors of the economy to develop side by side. The public sector, which includes enterprises owned by the whole people and enterprises owned by collectives, is to remain predominant, with the private sector, which includes individually owned and foreign-owned enterprises, as a supplement. Different sectors of the economy can operate jointly

in different ways on a voluntary basis. Enterprises owned by the whole people should play the leading role when they compete with others in the market on an equal footing.

So far as distribution is concerned, remuneration according to one's work will remain the predominant mode, with other modes as a supplement; these too, however, should be fair and based on performance. By using various means of regulation, including the market, we should encourage the advanced and help raise efficiency. We should widen differences in personal income to a reasonable degree, but at the same time we should prevent polarization and gradually bring about common prosperity.

Through macro-control a socialist country is able to integrate people's immediate interests with their long-term interests and the interests of some with the interests of all, exploiting the advantages of both planning and market forces. The state plan is an important means of macro-control. We should renew our concept of planning and improve our methods. When the state makes plans, its main tasks should be to set rational strategic targets for national economic and social development, to forecast economic development, to control total supply and total demand, to readjust the geographical distribution of industries and of the productive forces and to muster the financial and material resources necessary for the construction of important projects — all for the purpose of speeding up economic development by employing all economic levers.

Establishing and improving a socialist market economy will be a long process, because it is a difficult and complex feat of social systems engineering. We must be prepared to make sustained efforts, but at the same time we should work with a sense of urgency. We must keep to the correct orientation, but at the same time we should proceed in the light of actual conditions. During the process of establishing the socialist market economy, the extent to which planning is combined with market regulation and the form the combination takes may vary at different times, in different places and in different sectors of the economy. We should be bold in exploring new ways, dare to experiment and constantly review our experience so as to expedite the replacement of the old structure with the new. The establishment of a socialist market economy involves many spheres of the economic base and the superstructure, and it therefore requires corresponding structural reforms and the readjustment of a series of policies. We must draw up a general plan and carry it out step by step. We are convinced that a market economy established under the

socialist system can and should operate better than one under the capitalist system.

To accelerate the reform and opening up and to promote economic development and all-round social progress, we must redouble our efforts to fulfil the following ten major tasks, all of which involve the overall interests.

1. To accelerate economic reform while establishing a socialist market economy.

To establish a socialist market economy we must do the following important and interrelated tasks.

First, we must change the way in which state-owned enterprises operate, especially the large and medium-sized ones, and push them into the market so as to increase their vitality and efficiency. This is the key to establishing a socialist market economy, consolidating the socialist system and demonstrating its superiority. By straightening out the relations between ownership and management of enterprises, separating the functions of the government from those of enterprises and granting the latter more autonomy, we should turn them into legal entities responsible for their own decisions about their operation and expansion and for their own profits and losses. They should become the most competitive enterprises and take responsibility for preserving and increasing the value of the state assets. The contract system currently in force should be further improved. The shareholding system will help promote the separation of the functions of the government from those of enterprises, the change in the way enterprises operate and the accumulation of social capital. We should therefore try it out in selected enterprises, reviewing our experience regularly and formulating laws and regulations to ensure that the system develops in a sound and orderly manner. Where conditions permit, enterprises should be encouraged to join or amalgamate into enterprise groups. Some small state-owned enterprises may be leased or sold to collectives or individuals.

Second, we must accelerate the establishment of the market system. We should continue our efforts to develop commodity markets, especially for capital goods, and build up financial markets, including markets for bonds, stocks and other negotiable securities, and markets for technology, labour, information and real estate, so as to form an integrated national market system open to all. At the same time, we should strengthen market rules and regulations, dismantle the barriers between regions, prohibit embargoes and prevent the formation of monopolies, so as to promote competition on an equal footing. Reform of the pricing system is the key to the building of mar-

kets and the restructuring of the economy. It is therefore necessary to proceed more rapidly with that reform, in accordance with the tolerance of the different sectors of society, straightening out price relations and establishing a system in which most prices are determined by market forces.

Third, we must deepen the reform of the system of distribution and the system of social security. We should smooth the relations of distribution between the state and enterprises and between the central and local authorities, taking into consideration the interests of the state, of collectives and of individuals. We have to introduce gradually a system whereby enterprises pay tax plus a percentage of profits and a system whereby tax revenues are shared by central and local authorities. We should speed up the reform of the wage system, with the aim of gradually introducing different systems that are suitable for enterprises, institutions and government organs respectively, as well as a mechanism for normal increase of wages. We should also speed up the establishment of a system of social security covering unemployment, the aged and health and the reform of the housing system in cities and towns.

Fourth, we must accelerate the change in the functions of government. This is of major importance if we are to keep the superstructure in line with the economic base and to promote economic development. Unless we make substantial progress in this respect, it will be hard for us to advance the programme of reform and to establish a socialist market economy. The fundamental way to effect this change is to separate the functions of the government from those of enterprises. Governments at all levels should refrain from intervening in areas where the state has decreed that functions and powers belong to enterprises. Neither central nor local government departments may exercise powers that have been assigned to enterprises. The functions of the government are to make overall plans, to see that policies are carried out correctly, to offer guidance by supplying information, to organize and coordinate, to provide services and to inspect and supervise. Further efforts should be made to reform the management systems of the specialized departments in charge of planning, investment, finance, banking and so on and to tighten auditing and economic supervision. We should improve the systems and methods of scientific macro-management of the economy and divide the responsibilities for it rationally among the central authorities, provinces, autonomous regions and municipalities directly under the central government, giving full play to the initiative of each.

2. To open wider to the outside world and make more and better use of foreign funds, resources, technology and management expertise.

The number of areas and regions open to other countries needs to be increased. Exchanges can take place in all domains, at different levels and through many channels. Continued efforts should be made to improve the management of the special economic zones, the open coastal cities and the open coastal economic development areas. We must open more areas along the borders and in the interior provinces and autonomous regions. We should also open more cities along the Yangtze River, while concentrating on the development and opening of the Pudong Area of Shanghai. We want to make Shanghai one of the international economic, financial and trade centres as soon as possible and to bring about a new leap in economic development in the Yangtze River Delta and the whole Yangtze River basin. We should accelerate the opening and development of Guangdong, Fujian, Hainan and the rim of Bohai Bay, enabling Guangdong and other areas where conditions are ripe to basically achieve the goal of modernization in 20 years.

We should open up more areas to foreign investment. We should continue to improve the investment environment and provide better conditions for foreign businessmen to invest and do business in China, and we should give them full legal protection. We should attract foreign investment in accordance with the national industrial policy, channeling it into infrastructural facilities, basic industries, enterprises that need to be technically transformed or that are capital- or technology-intensive and also, in a certain measure, into banking, commerce, tourism, real estate and other domains. We should ensure rational distribution and better management of the economic and technological development zones and the development zones for industries using high and new technology.

We should open up more international markets, diversify our trading partners and develop an export-oriented economy. We should expand export trade, change the export product mix and export high grade commodities of good quality. At the same time, we should increase imports in an appropriate amount and make use of more foreign resources and advanced technology. We should deepen the reform of the system for managing foreign trade and establish, as soon as possible, a new system that is in keeping with the development of the socialist market economy and conforms to international norms. We should grant to enterprises and to science and technology research institutes the power to engage in foreign

trade, and we should encourage enterprises to expand their investments abroad and their transnational operations.

3. To readjust and optimize the structure of production, put great effort into agriculture and accelerate the development of basic industries, infrastructural facilities and the tertiary industry.

In light of the current condition of our economy and its trend of development, we should try to raise the level of agriculture, which is the primary industry, and steadily increase its output. We should continue expanding the secondary industry and readjusting its structure, and we should make greater efforts to promote the tertiary industry.

Agriculture is the foundation of the national economy. We must continue to give first priority to developing it, and we must revitalize the whole rural economy. We must recognize the importance of diversification and, while ensuring that the output of grain and cotton increases steadily, continue to adjust the agricultural structure. We should do all we can to expand farming, forestry, animal husbandry, sideline production and fisheries, and to develop a highly efficient agriculture that provides greater and better yields. We should persist in revitalizing agriculture by relying on science and technology and on education. We should increase investment in agriculture in different forms and through different channels, continue our efforts to build water conservancy projects and constantly raise the level of intensive management and overall productivity. We should vigorously expand township enterprises, particularly supporting those in the central and western parts of the country and in areas inhabited by people of minority nationalities.

We must carry out the decision of the Eighth Plenary Session of the 13th Central Committee in all respects by further restructuring the rural economy and reforming the methods of operation. We should try to stabilize for a long time to come, and constantly improve, the responsibility system, the main form of which is the household contract that links remuneration to output, and the system of unified management combined with independent management. We should develop diverse forms of collectivized agricultural services and gradually increase the economic strength of collectives, as actual conditions in various places allow. We should move faster to reform the pricing system for agricultural products and the rural circulation system. In developing the rural economy we should continue to expand the regulatory role of the market.

Rapid development of such infrastructural facilities and basic industries as transportation, te-

lecommunications, energy, important raw and semi-finished materials and water conservancy is urgently needed both to accelerate economic development now and to prepare for further development later. For this purpose, we should concentrate on building efficiently a certain number of "backbone" projects of high quality. We should lose no time in launching construction of the key Yangtze Three Gorges water conservancy project, the project to divert water from the Yangtze River to north China, the railway for transporting coal from west to east China, the 10-million-ton iron and steel complex and other super-projects that will not be completed until the next century.

We should intensify geological exploration. We should revitalize the machine-building and electronics industries, the petrochemical industry, the automobile industry and the construction industry to make them the pillars of the economy. We should lose no time in developing high- and new-technology industries. Ordinary enterprises in textiles, processing and other light industries should increase their efficiency and raise their technical level through association, reorganization and technical transformation. Full attention should be paid to economizing energy and raw and semi-finished materials so that resources can be put to best use. So far as investment in fixed assets is concerned, we should give priority to infrastructural facilities, basic industries and projects for the technological transformation, rebuilding and expansion of existing enterprises, especially those for the technological transformation of the old industrial bases and of "backbone" enterprises.

A flourishing tertiary industry is one of the important features of a modern economy. At present, the total value of services in China is far less than it is in developed countries and even in many other developing countries. An expansion of commerce, banking, insurance and tourism, of services in the fields of information, law, accounting and auditing and also of neighbourhood services will augment the growth of the market. It will also help to socialize and professionalize services, to achieve better economic results and increase efficiency, and to ensure convenience for the people and enrich their lives. Moreover, it will create employment opportunities and provide the necessary conditions for readjusting the economic structure, changing the way enterprises operate and reforming the government structure. We must call upon the initiative of the state, collectives and individuals and step up development of the tertiary industry so as to greatly increase its proportion in the GNP.

4. To accelerate progress in science and technol-

ogy, make special efforts to develop education and give full scope to the abilities of intellectuals.

Science and technology constitute a primary productive force. If the economy is to be revitalized, it is necessary first and foremost to promote the development of science and technology. Only steady progress in those domains will enable us to gain the initiative in sharp competition. At a time when we are facing the major tasks of accelerating development, readjusting the economic structure and improving performance, it is especially necessary to make all sectors of society more aware of the importance of science and technology and of the need to increase investment in them, so that progress in those fields will provide the basis for economic development. Scientific and technological work should be geared to economic development, which is our main field of endeavour. Personnel should be divided rationally among three areas: development research, development of high and new technology and of industries using it, and basic research. Scientists and technicians should set themselves the goal of scaling the heights: the Chinese nation must take its place in the realm of advanced science and technology.

By deepening the reform, we should establish a mechanism for integrating science and technology with the economy, making them real productive forces by speedily commercializing research results. We should constantly improve the protection of intellectual property rights. We should assimilate advanced technologies from abroad and improve upon them. We must increase the contributions of high technology to economic growth, so as to bring about a change from extensive to intensive management of the economy as a whole.

Scientific and technological progress, economic prosperity and social advances are all basically dependent on the raising of the educational level of workers and the training of personnel. Accordingly, we must make education a strategic priority. If we are to modernize China, it is of fundamental importance to raise the ideological and ethical standards and the scientific and educational levels of the whole population. We have to make the educational structure as effective as possible and to do all we can to strengthen basic education, expand vocational and adult education, develop higher education and encourage independent study. Governments at all levels should devote more resources to education and urge all non-governmental sectors to pool funds to open schools of different types, thus breaking up the state monopoly of education. Schools of all types at all levels should implement the Party's

principles with regard to education and raise the overall quality of instruction. We should try to eliminate illiteracy among most young and middle-aged people by the end of the century and to institute nine-year compulsory education in most places by that time as well. We must further reform the educational system, the content that is taught and the methods of teaching it, strengthen the training of teachers, grant schools more autonomy and promote the integration of education with the development of science and technology and of the economy.

Intellectuals are members of the working class who have a better scientific and general education than others and who, as pathbreakers, constitute advanced productive forces. They have an especially important role to play in the reform, the opening up and the modernization drive. Whether we do or do not give full scope to their abilities will determine, to a considerable degree, the prosperity or decline of our nation and the success or failure of the drive for modernization. We should strive to create a better environment for intellectuals that will allow them to use all their skills and knowledge, and we should make further efforts to create an atmosphere of respect for learning and for professionally trained people.

We are determined to adopt policies and measures to improve the working, studying and living conditions of intellectuals and to reward handsomely those who make outstanding contributions. We should introduce a regular reward system. We appreciate it when our people studying abroad show concern and support for the drive to modernize the motherland and become involved in it in various ways. When they come back to participate in socialist construction, they will be warmly welcomed no matter what their political attitudes were in the past; proper arrangements will be made for their employment, and they will be allowed to come and go freely and easily. Intellectuals have made tremendous contributions to the cause of socialist modernization. We have no doubt that they will live up to the ardent hopes of the state and the people and prove worthy of the trust placed in them by working even harder to make fresh contributions.

5. To exploit the particular advantages of each region, accelerate its economic development and rationalize the geographical distribution of the different sectors of the economy.

The territory of China is so vast that conditions vary greatly from place to place, and so does the level of economic development. We should try to achieve a rational pattern of industry and promote the healthy development of regional economies under the guidance of unified planning by the

state. We should proceed in the light of local conditions and in accordance with a rational division of labour, with all the regions exploiting their own particular advantages for mutual benefit and prosperity.

The coastal region in east China should make every effort to develop an export-oriented economy, concentrating on developing products that yield a high added value, earn foreign exchange and are produced with advanced technology and an efficient use of energy and raw and semi-finished materials. The region should use more foreign capital and other foreign resources to achieve a higher growth rate and better economic performance.

Through overall planning, the state should support the central and western regions, which are endowed with rich natural resources, and the border areas there, which have great potential for opening to the outside world. To help establish a market economy, these regions and areas should open up faster to the other parts of the country and to the outside. They should build more infrastructural projects to facilitate the utilization of their natural resources and develop industries and products for which they are particularly well adapted. Where conditions permit, they should build up the export trade so as to stimulate the development of the entire local economy.

Instead of attempting to build complete, self-sufficient economies of their own, the regions should do everything in the interest of the nation as a whole, avoiding construction of redundant projects and duplication of imports. We should promote rational exchange and cooperation between regions, so as to form a new pattern of circulation that will be beneficial to all. In our effort to develop regional economies on the basis of their natural geographical features and existing economic links, we should take full advantage of key cities.

To strengthen national unity, consolidate frontier defence and promote economic development nationwide, it is extremely important to bring about faster development in areas inhabited by people of minority nationalities. The poor regions must shake off poverty and set out on the road to prosperity as soon as possible. That is one of our strategic objectives for the second stage of China's development. The state should adopt effective policies to support areas inhabited by people of minority nationalities, the old revolutionary base areas, border areas and poor areas. In one way or another, economically developed regions should also help them develop.

6. To push forward reform of the political structure and bring about great advances in socialist

democracy and in the legal system.

To keep pace with economic development and the reform of the economic structure, it is imperative to push forward reform of the political structure, bearing in mind that promotion of democracy must be closely combined with improvement of the legal system. The goal of this reform is to build a socialist democracy suited to Chinese conditions and in no respect a Western, multiparty, parliamentary system. The Constitution of our country provides that the state organs of the People's Republic of China shall apply the principle of democratic centralism, which is a fundamental principle in China. Democracy among the people is an essential requirement for socialism and one of its intrinsic characteristics. Without democracy and a legal system, there can be no socialism or socialist modernization. We should make notable progress in developing socialist democracy and perfecting the socialist legal system, so as to consolidate the stable social and political environment and ensure the smooth progress of economic development, the reform and the opening to the outside world.

We should further improve the system of people's congresses, strengthen the functions of the congresses and their standing committees in legislating, exercising supervision and so on and expand the role of the people's deputies. We should improve the system of multiparty cooperation and political consultation under the leadership of the Communist Party. In this new period we should consolidate and broaden the patriotic united front and let the people's political consultative conferences play a greater part in political consultation and in democratic supervision. We should continue to abide by the principles of "long-term coexistence and mutual supervision" of the various parties and "treating each other with all sincerity and sharing weal or woe". We should reinforce the practice of consulting with the democratic parties and support the appointment of their members and of persons without party affiliations to leading posts in state organs, with a view to solidifying the alliance of our Party with non-Party people.

For our unified, multinational state, the great solidarity of all nationalities is an important guarantee that the motherland will remain unified and that socialist modernization will be realized. It is essential to implement all the Party's policies with regard to the nationalities. We must perfect the system of regional autonomy in areas inhabited by minority nationalities and adhere to the principle of equality, mutual assistance, unity and co-operation among all nationalities so as to promote common prosperity. The Party's policies

on religion and on the affairs of overseas Chinese must likewise be carried out conscientiously in the service of socialist modernization.

Scientific and democratic decision-making is essential to democratic centralism and to the building of socialist democracy. Leading organs and leading cadres must listen attentively to the opinions of the people, seek advice from experts in different fields and from research and consultancy institutions and establish a system of democratic and scientific decision-making as soon as possible. We must strengthen democracy at the grassroots level and see to it that the congresses of workers and other employees, the neighbourhood committees and the village committees function well. We should improve the work of the organs supervising law enforcement and government administration, recognize the importance of supervision by public opinion through the media and gradually perfect the supervisory mechanism, so that government organs at all levels and their staff will be brought under effective supervision.

All due attention should be given to the legal system. To establish a socialist market economy, we urgently need to strengthen legislation. In particular, we need to draw up laws and regulations that will ensure smooth progress of the reform and the opening up, and provide for better management of the overall economy and standardize the economic behaviour of enterprises and individuals. It is essential to enforce the Constitution and other laws strictly, to supervise their enforcement, to put an end to arbitrary intervention by persons in authority and to correct the practice of replacing imprisonment for criminal offenses with lighter punishment. We must ensure the independence of the people's courts and procuratorates in their work. We should strengthen public security, the procuratorates and the people's courts and improve the quality and competence of their personnel. To enhance the understanding of the people, including the cadres, of democracy and the legal system, education must be combined with practice.

Good public order is of major importance because it is of immediate concern to the people and because it is necessary to ensure social stability and economic development. We must adopt effective measures to put an end to the disorder that exists in some places. We must strengthen the people's democratic dictatorship and rely on close cooperation between the relevant organs and the people in an effort to improve all facets of public security. To uphold justice and protect the people, we must crack down on the activities of hostile forces and of criminals.

7. To reform the administrative system and the organizational structure of the Party and the government so as to bring about a change in their functions, straighten out their relations, simplify administration and improve efficiency.

If we are to reform the political structure, deepen the economic reform, establish a market economy and accelerate the modernization drive, we must make it our urgent task to reform the organizational structure and to simplify administration. At present, the overstaffing, overlapping and inefficiency of many Party and government organizations cut them off from the masses and so greatly hamper the efforts to change the way enterprises operate that there is no alternative to reform. Party committees and governments at all levels must reach a common understanding on this matter. They must make up their minds to reform the current administrative system and their organizational structure, in accordance with the principles of separating the administration of the government from the management of enterprises and achieving simplification, uniformity and efficiency.

The departments in charge of the overall balance of the economy should turn their attention to enhancing macro-economic control. Some specialized economic departments and some organizations whose functions overlap or whose work is similar must be abolished or merged, and the number of temporary, *ad hoc* organizations should be considerably reduced. Party and government organs must cut back personnel so that they do not exceed their authorized size.

To reform organizational structure and simplify administration is an arduous task that will demand overall planning, meticulous organization, concerted efforts by people at all levels and phased implementation. We should try to complete it basically within three years. In the course of reducing personnel, we should raise efficiency and develop the productive forces. On the one hand, we want to rationalize the structure of Party and government departments and improve the quality of personnel; on the other, we want to transfer to the service sector and to other jobs where they are needed large numbers of professionally trained people, who will become a vital new force in the modernization drive.

We must accelerate the reform of the personnel and labour systems and gradually establish scientific management systems and effective incentive mechanisms appropriate to Party and government departments, to enterprises and to institutions. The reform in this connection must be combined with the reform of the organizational structure and of the wage system. The system of

public service must be put in place as soon as possible.

8. To continue to foster both material progress and cultural and ideological progress, attaching equal importance to both.

The reform, the process of opening to the outside world and the modernization drive are stimulating the Chinese people to emancipate their minds, acquire a broader outlook, turn their attention to the future and to the world at large and exert every effort to advance material wellbeing. At the same time, these new undertakings call for greater cultural and ideological progress. Only when there is both material progress and cultural and ideological progress can there be socialism with Chinese characteristics. Progress in this second sphere must be closely linked to the central task of economic development, providing our development, reform and opening to the outside world with a powerful ideological driving force and with strong intellectual support.

The emphasis must be on progress. We should attach great importance to theoretical work, protect academic freedom, take care to integrate theory with practice, initiate creative research, develop philosophy and other social sciences and uphold and advance Marxism. We should train more young and middle-aged theoretical workers so as to raise their professional competence. We should adhere to the principles of serving the people and the cause of socialism and of letting a hundred flowers blossom and a hundred schools of thought contend. We should push forward the reform of the system of managing cultural undertakings, improve our economic policies concerning them and promote a flourishing socialist culture. We should attach importance to the social impact of works of art and encourage the creation of works with healthy content and aesthetic value, especially ones in praise of reform, opening to the outside world and modernization. We should do better work in the fields of the press and publishing, radio and television, literature and art. We should use ideological and political work to arouse the enthusiasm of the masses for devoting themselves to socialist construction.

We should teach the people of all nationalities, especially young people, about the Party's basic line, about modern and contemporary history and about the present conditions of our country, fostering patriotism, community spirit and socialist ideology. Thus, they will come to prize national dignity, self-confidence and self-reliance. They will resist the corrosive influence of the decadent capitalist and feudal ideologies and cherish correct ideals, convictions and values.

In every trade and profession, we should culti-

vate ethical conduct, gradually developing norms of occupational ethics appropriate to each and resolutely overcoming unhealthy practices such as the abuse of power for personal gain. We should strengthen education in social ethics and make a point of commending model workers who embody the spirit of the age. Communities, villages, townships, enterprises and schools should all work for cultural progress. We should continue to have model communities and units established jointly by the army and the people and by the police and the people, so as to achieve cultural progress at the grassroots level in both town and country. Cultural progress requires material support. We should increase investment in this area through all channels and include cultural facilities in the overall programme of urban and rural construction.

The spread of social evils damages people, especially young people, both physically and mentally, impedes the modernization drive, reform and opening to the outside world, and mars the image of socialism. These evils are therefore detested by the people, and we should wage a determined and effective long-term campaign to wipe them out.

Party committees at all levels should review the experience they have gained since we began the reform and the opening to the outside world, so as to improve their leadership in the effort to achieve cultural and ideological progress. We should maintain and enrich the fine traditions of the Chinese nation, assimilate the best achievements of other peoples and create an advanced culture and ideology through the rich, active practice of building socialism. We should create a favourable environment for the reform, the opening up and the modernization drive and nurture one generation after another of citizens who have high ideals, moral integrity, a better education and a strong sense of discipline.

9. To continue improving people's living standards, strictly control population growth and strengthen environmental protection.

The purpose of accelerating the reform, the opening up and economic development is to meet the growing material and cultural demands of the people. As production expands and social wealth increases, the real incomes, the consumption levels and the living standards of both urban and rural people will rise markedly. Their food, clothing, transportation and especially their housing will greatly improve. Their cultural life will grow richer, physical culture will develop, public health services will improve and the general level of health will rise.

It will be a magnificent achievement when the people of our country — one-fifth of the world's

population — can lead a relatively comfortable life. At the same time, it should be remembered that China started with a poor economic foundation and that in this pioneering stage of the modernization drive we need more funds for construction. We must therefore continue the fine tradition of building the country through hard work and frugality. We should encourage people to practise economy.

We should firmly carry out the basic state policies of controlling population growth and strengthening environmental protection. We must never let up in the work of family planning. We should make sure that the established goal of population control is attained, promote prenatal and postnatal care and improve the people's health. We should study the ageing of the population and take appropriate measures to deal with it. We should increase the people's awareness of the importance of the environment, so that they will help preserve land, mineral resources, forests, water and other natural resources, use them wisely and protect the ecology.

10. To strengthen the army and increase our defence capabilities so as to guarantee the smooth progress of the reform, the opening up and economic development.

The Chinese People's Liberation Army is the strong shield of the people's democratic dictatorship, a great wall of steel protecting the socialist motherland and an important force for building socialism with Chinese characteristics. Now and for a long time to come, our drive for socialist modernization will be conducted in a complex and changing international environment. It is essential always to uphold the Party's absolute leadership over the army. In accordance with Comrade Deng Xiaoping's concept of army-building in the new period, we must create the best armed forces that our conditions permit, turning the PLA into a strong, modernized, revolutionary regular army and constantly increasing our defence capabilities, so as to provide powerful protection for the reform, the opening up and economic development. We have already cut the size of the army by one million men. From now on, it must work hard to meet the requirements of modern warfare, pay attention to quality and enhance its overall combat effectiveness. Thus it will be ready to perform even better the sacred mission of defending China's interests, its sovereignty over its territory, territorial waters and air space, and its maritime rights and of safeguarding the unity and security of the motherland. At the same time, the army must consciously subordinate itself to the overall interests of national economic development, actively support and par-

ticipate in the reform, the opening up and the modernization drive and make its contributions to China's development and prosperity.

The army must strengthen and reform itself, giving education and training strategic importance and improving the overall combat effectiveness of officers and men. All army units must be qualified politically and competent militarily. They must have a fine style of work, maintain strict discipline and be assured of adequate logistical support. To gradually improve weapons and equipment we must recognize the importance of scientific and technological research for national defence and that of the defence industry.

As always, Party organizations, governments at all levels and all the Chinese people should be concerned with strengthening national defence and should support the army in its tasks. We must educate the people about the importance of national defence. The army should never abandon the work it does to support the government and show its concern for the people, and the government should never abandon its support for the army and its preferential treatment of families of revolutionary army men and martyrs. This will improve the excellent situation in which both the army and the government on the one hand and the army and the people on the other are united and support each other. We must make a success of the work with regard to the militia and reservists, constantly building up the reserves for national defence.

The Chinese People's Armed Police is an important force for protecting the drive for socialist modernization. We must continue to strengthen that force, together with the public security and state security departments, so they can be more effective in maintaining national security and social stability.

Comrades,

The reform, the opening to the outside world and the modernization drive are great undertakings of the people. To accomplish the arduous tasks of the 1990s, we must rely wholeheartedly on the working class and on the rest of the vast labouring people, giving full play to their enthusiasm and creativity. So long as the Chinese people of all nationalities remain closely united and work hard for the prosperity of the country and for socialist modernization, our cause will surely triumph.

III. The International Situation and Our Foreign Policy

In the complex and volatile world situation, we have scored major achievements in our relations

with other countries. The People's Republic of China has cemented optimum good-neighbour relations with surrounding countries since its founding, has strengthened its solidarity and cooperation with the large numbers of developing countries and has improved and expanded its relations with all countries, including the developed ones in the West, on the basis of the Five Principles of Peaceful Co-existence. China's international influence has steadily increased and its international standing has risen.

The world today is in a historical period of great change. The bipolar structure has come to an end, forces are disintegrating and their elements are being realigned and the world is moving in the direction of multipolarization. The formation of a new structure will be a long and complex process. For a long time to come, it will be possible to secure a peaceful international environment and avert a new world war. At the same time, it should be pointed out that the current international situation remains turbulent. Contradictions everywhere are deepening, and in quite a few countries and regions ethnic contradictions, territorial disputes and religious conflicts have sharpened and have even led to bloodshed and local war. International economic competition has become increasingly intense. The economies of many developing countries have deteriorated even more, and the gap between North and South has further widened.

The questions of peace and development remain the two top priorities on the international agenda today. Development needs peace, and peace cannot be maintained without development. Hegemonism and power politics have all along constituted the main obstacles to peace and development. World development cannot be based for long on the poverty and backwardness of the great number of developing countries. The drastic changes and turmoil of the international situation have helped awaken the world's people. Among the developing countries that have shared common experiences, the trend of safeguarding independence and sovereignty and seeking solidarity and cooperation is gaining momentum. The world needs peace, countries need to develop, society needs to progress, economies need to thrive and living standards need to improve. These have become the universal demands of the world's peoples.

Faced with the new international situation, the Communist Party of China, the Chinese government and the Chinese people will continue to develop their relations with foreign countries, to seek a favourable international environment for China's reform, opening up and modernization

and to make their own contributions to world peace and development.

China has consistently pursued an independent foreign policy of peace. The basic objectives of that policy are to safeguard our independence and sovereignty and to promote world peace and development. On questions involving our national interests and state sovereignty, we shall never yield to any outside pressure. China will always stand firm as a strong defender of world peace. It will not enter into alliance with any country or group of countries and will not join any military bloc. China will never seek hegemony and expansion; it is opposed to hegemonism, power politics, aggression and expansion in any form. China is against the arms race and stands for effective disarmament and arms control carried out in a fair, reasonable, comprehensive and balanced manner. Today, some countries are calling for disarmament too, but they have not, in effect, reduced the number of their sophisticated weapons. In handling international affairs, China abides strictly by the Charter of the United Nations and the acknowledged norms of international relations and adheres to the principled position of seeking truth from facts and upholding justice.

The nature of the new international order that is to be established is a question of great concern to the international community today. In view of past experience and present reality, we advocate the establishment of a peaceful, stable, just and rational new international order on the basis of the five principles of mutual respect for sovereignty and territorial integrity, mutual non-aggression and non-interference in each other's internal affairs, equality and mutual benefit and peaceful co-existence. Such a new order would include a new international economic order based on equality and mutual benefit.

The world is diverse, and differences of all kinds exist among nations. The peoples of all countries are entitled to choose the social systems and paths of development that suit their specific conditions. All nations, big or small, strong or weak, rich or poor, should take part in international affairs as equal members of the international community. All nations should respect each other, seek common ground while putting aside differences, treat each other as equals, and live together in amity. The differences and disputes between nations should be resolved peacefully through negotiation, in compliance with the United Nations Charter and the norms of international law, and force or the threat of force should not be used. Hegemonism and power politics — that is, the monopoly and manipulation of international affairs by a few countries — will

not be tolerated. The establishment of a new international order is a long-term undertaking, and the Chinese people, together with all other peoples of the world, will make unremitting efforts to accomplish it.

As a member of the United Nations and a permanent member of the Security Council, China attaches great importance to the work of the United Nations and actively participates in it. We support the United Nations and the Security Council in their efforts to preserve world peace, promote disarmament, push forward global development and settle international disputes.

China is a developing country. A key element of our foreign policy is to strengthen our solidarity and co-operation with other third world countries. China and the other developing countries will, as always, support each other in safeguarding their independence and sovereignty and will increase their economic and cultural exchanges. China has become an observer of the Non-Aligned Movement and has established close ties with the Group of 77 as well. We shall further strengthen our co-operation with them.

China is willing to develop friendly relations and co-operation with all other countries on the basis of the Five Principles of Peaceful Co-existence. The differences in social systems and ideologies should not constitute obstacles to the development of relations between nations. In international contacts, China will never try to impose its social system or ideology on other countries, nor will China allow other countries to impose their social systems and ideologies on it. This is a principled position and it will never change.

China is firmly determined to open to the outside world and is ready to increase its economic, scientific and technological co-operation with all countries on the basis of equality and mutual benefit and to promote exchange in the fields of culture, education, health and sports.

The Communist Party of China values its relations with the political parties of other countries. It has already established ties of various sorts with political parties and organizations in more than 100 countries. We shall continue to develop friendly relations with such parties in accordance with the principles of independence, complete equality, mutual respect and non-interference in each other's internal affairs and to increase mutual understanding and co-operation in the spirit of seeking common ground while putting aside differences.

The founding of the People's Republic of China put an end to the Chinese people's tragic history of suffering from long aggression, oppression and

humiliation, and it fundamentally changed the situation of human rights in China. The people have become the masters of the country and have steadily built their own new life. The Constitution of our republic has given basic protection to all the people's rights. China has acceded to a series of international conventions on human rights and agrees to the conduct of international dialogues on human rights on an equal footing. In the final analysis, the question of human rights is a matter within each country's sovereignty; China is resolutely opposed to the use of human rights to interfere in other countries' internal affairs.

Historical experience has taught us that whenever, on any pretext, any country encroaches upon the independence and sovereignty of others and interferes in their internal affairs, or whenever any big, strong or rich country coerces, humiliates and intimidates countries that are small, weak or poor; it will be internationally condemned. Any country that overreaches itself or rides roughshod over others will be denounced by the peoples of the world. A just cause enjoys abundant support, while an unjust cause finds little. The forces championing a just cause are always invincible.

IV. Strengthening Party-Building and Improving Party Leadership

We must follow the basic line of the Party unswervingly for a long time to come; we must rapidly carry out the socialist reform, the opening to the outside world and the modernization programme; and we must maintain long-term stability and make our country prosperous and strong. The key to all this is our Party, a party armed with Comrade Deng Xiaoping's theory of building socialism with Chinese characteristics.

For more than seven decades the Communist Party of China has united the Chinese people of all nationalities and led them in a struggle to overcome all difficulties and hardships and make a fundamental change in their status, in the direction of Chinese history and in the image of Chinese society. Since the Third Plenary Session of the Eleventh Central Committee, it has led the people in an effort to create a new situation of reform, opening up and modernization in every field of endeavour. The great, glorious and correct Communist Party of China, which led the people to victory in the revolution, can also lead them to victory in the reform and in economic development. It would be absolutely wrong and harmful for anyone to doubt, weaken or negate the Party's position in power and its leading role.

In the new historical period there have been

major changes in the environment in which our Party functions and in the tasks it undertakes. Ideologically, politically, organizationally and in terms of work style, it is faced with many new situations and problems. In light of the new realities and in compliance with the Party's basic line, we must adhere to the principle that the Party handles Party affairs, being strict with its members, improving Party building and exercising more effective power and leadership. This will make it possible for our long-tested Marxist Party to function better as the force at the core providing leadership in the reform, the opening to the outside world and the drive for modernization.

1. We should study the theory of building socialism with Chinese characteristics and increase our awareness of the need to firmly carry out the Party's basic line.

Our Party is the vanguard of the working class, and Marxism-Leninism and Mao Zedong Thought are the guides to our action. Marxism is a science that is deeply rooted in practice and developed through practice. The theory of building socialism with Chinese characteristics is the latest product of the integration of Marxism with Chinese reality. It is a Marxist theory for present-day China. It is a powerful ideological weapon that will enable us to fulfil our new historical mission. When we talk about the need to study Marxism-Leninism and Mao Zedong Thought, we mean in essence the need to study that theory. Leading Party members, high-ranking cadres in particular, should be the first to study it and apply it in practice. We should try to understand Comrade Deng Xiaoping's strategy, theories and viewpoints and to emulate his scientific approach in examining new situations and his creativity in solving new problems by applying the Marxist stand, viewpoint and method. We should learn the basic theories, integrate them with practice, and know how to use them effectively. We hope that through study, all our Party cadres will acquire a firm faith in socialism and communism, constantly raise their political level and their ability to solve practical problems, and transform their consciousness into tremendous material strength that will serve to accelerate the reform, the opening up and the drive for modernization.

Emancipating our minds and seeking truth from facts are the essence of the theory of building socialism with Chinese characteristics and a "magic weapon" guaranteeing that our Party will always be vigorous. The two precepts are identical. They mean that we should keep our understanding in line with current realities, that under the guidance of Marxism we should break the

shackles of traditional conceptions and subjective prejudices and overcome our habit of following the beaten track and rejecting new things. We must not simply cling to certain Marxist principles, to a dogmatic interpretation of certain theories, to an unscientific or distorted understanding of socialism or to ideas that are wrong because in the primary stage of socialism they are premature. Instead, we must try to analyse and solve problems with the world outlook and methods of dialectical materialism and historical materialism, adapting our thinking to changing circumstances. In the course of reform and economic development, leading organs and leading cadres at all levels should integrate the Party's line, principles and policies with the actual conditions in their localities or departments. They should courageously explore new ways, conduct bold experiments, frequently review their experience and seek creative solutions to problems.

We should be keenly aware that because modern science and technology are progressing rapidly and the socialist market economy is constantly expanding, there are many new things we need to understand and become familiar with. All our Party comrades must regard it as an urgent, long-term task to learn through practice. We should study not only political affairs but also economic affairs, advanced techniques of production and management, and modern science and culture. We should work hard to gain professional proficiency and become skilled in our work.

2. We must build strong leading bodies and train successors to the socialist cause.

In accordance with the principle of making the contingent of cadres more revolutionary, younger, better educated and more competent, with both professional ability and political integrity, we must help make the leading bodies at every level staunch collectives that are devoted to Marxism and will resolutely follow the road to socialism with Chinese characteristics. This is of vital importance for guaranteeing the continuity of the Party's line and the long-term peace and stability of the country.

In judging the integrity and ability of cadres, we must look primarily at their performance in carrying out the Party's basic line. We must appoint the right cadres to important posts. They should be persons who firmly carry out the basic line, who are highly revolutionary and enterprising and who have a strong sense of their responsibility to serve the people. They should have scored outstanding achievements in the reform, the opening up and the modernization drive and have gained the trust of the people. We must replace those cadres who are irresponsible, have

proved incompetent or have abused their power for personal gain. Persons who think only of themselves or who merely crave official positions can never be assigned to important posts. In selecting cadres for promotion, we must follow democratic procedures and the mass line and act strictly in accordance with regulations, preventing or correcting unsound practices.

Selecting a large number of fine young cadres to become leaders at different levels is currently a pressing and important task. To accomplish it we must break with the old notions of following seniority and seeking absolute perfection, widen the range of our search and open up new channels of advancement. We should take good care of young cadres and set high demands on them. We should make an effort to foster and promote women cadres and cadres from among the minority nationalities. We should continue the practice of transferring cadres from one job to another as appropriate. We should strictly enforce the cadre retirement system and continue to replace older cadres with younger ones while encouraging cooperation between them. We should take practical measures to show concern for retired cadres both politically and in terms of material benefits, giving them some work to do and making arrangements for them to enjoy their remaining years.

The consolidation and development of socialism will require one generation after another of hard, persistent, unyielding struggle. The responsibilities are heavy and the road is long; our hopes must be placed on the young. We must win the youth if we are to win the future. The Communist Youth League is the Party's assistant and its reserve force; we must take full advantage of it to unite and educate young people. The whole Party and the whole society should be concerned about the healthy growth of our children and adolescents. In the process of reform and economic development, we must work hard to nurture tens of millions of successors to advance the socialist cause.

In the course of our socialist modernization, attempts to bring about a peaceful evolution toward capitalism and the struggle against those attempts will continue for a long time, so we cannot let down our guard. Senior Party cadres, in particular, must always bear this in mind.

3. The Party should maintain close ties with the masses and resolutely eliminate corruption.

The people are the source of our strength, and their support is the basis of our success. The Party's basic line, principles and policies adopted since the Third Plenary Session of the 11th Central Committee conform to the interests of the people, and the Party has maintained basically

good relations with the people. But at the same time, we must recognize that some leading comrades are still bureaucratic or formalistic or show other failings in their work, and that a few Party cadres violate the law and discipline. This has seriously tarnished the reputation of the Party and damaged its relations with the people.

Every Party member should remember that at all times and under all circumstances he must serve the people wholeheartedly and keep to a good work style, integrating theory with practice, maintaining close ties with the masses and making self-criticisms. Leading bodies and leading cadres at all levels should go down to the grass-roots units, investigating and studying matters at first hand, so as to get to know the wishes of the people, help alleviate their hardships and take heed of their criticisms. They should also reduce the number of meetings they hold and documents they issue, emphasizing instead practical work for practical results. In this way they will be able to advance the fundamental aims of the Party, maintain a good work style and follow the mass line in practice.

The Party should improve its leadership of the trade unions, the Communist Youth League, the women's federations and other mass organizations and encourage them to serve as a bridge linking the Party with the masses.

The fight against corruption is crucial to the maintenance of close ties between the Party and the people. We should all recognize that this is an urgent, long-term and arduous struggle. Throughout the course of the reform and the opening to the outside world, we must combat corruption and make determined efforts to improve the Party's work style and to build clean government. If we want to win the people's confidence, we must be successful in this. Leading bodies and leading cadres at all levels should set an example by performing their official duties honestly and diligently for the people. Leading Party cadres, high- and middle-ranking ones in particular, should be strict with themselves, set a good example, teach their children to do the same and take the lead in combatting corruption. To build clean government we should rely on education, and especially on the legal system.

Party organizations and discipline inspection organs at all levels should exercise strict supervision over Party cadres. We should also encourage the people, the democratic parties and persons without party affiliation to do the same. For this purpose, we should institute a system under which people both inside and outside the Party can supervise it, with Party members doing so either from the top down or from the bottom up.

In particular, we should take effective measures to prevent law enforcement departments and cadres who are responsible for assigning personnel and distributing financial and material resources from abusing their power for personal gain and from perpetuating other undesirable practices. Persons who are corrupt damage the Party and harm the people, so they must be punished in accordance with the rules of Party discipline and the laws of the state.

4. We should strengthen primary Party organizations and encourage Party members to play an exemplary, vanguard role.

The primary Party organizations are the locus of all the Party's work and the base of its fighting capacity. Party committees at all levels should try to turn those organizations into a powerful force that can unite with the masses and lead them in reform and socialist construction. In rural areas, we should make a greater success of building village-level organizations with Party branches as the nuclei. In state-owned enterprises Party organizations should likewise be the political nuclei. They should continue to improve the system under which the factory director assumes full responsibility and to rely wholeheartedly on the working class. Other economic organizations should proceed from their own conditions and lose no time in establishing Party organizations and drawing up rules to govern their work. In addition, the primary Party organizations in government departments, schools, research institutes and urban neighbourhoods should strengthen themselves as necessary. We should make a particular effort to draw into the Party excellent workers, farmers and intellectuals who are working in the forefront of production. Some primary Party organizations are weak at present, so Party committees at the next higher level should send cadres there to help consolidate them.

The new historical period places new demands on Party members to set an example. It is therefore essential to educate and supervise them more effectively, increase their ability and cultivate their Party spirit. Our goal is that, as advanced elements, they should faithfully carry out the Party's basic line, devote themselves to the reform, the opening up and the modernization drive, work heart and soul for the interests of the people and, together with them, contribute to economic development and social progress. All Party members should be urged to emancipate their minds, emphasize reform and innovation, respect science and do practical work. They should take into consideration the situation as a whole, unite and coordinate their efforts, be modest and prudent, learn from the advanced and

work hard to make contributions and attain goals without considering their own interests. In this way, Party members can fully play a vanguard role in promoting both material progress and ideological and cultural progress.

5. We should uphold and improve the system of democratic centralism and safeguard Party solidarity and unity.

Modernization, reform and opening to the outside world are Herculean undertakings. Only by combining centralism based on democracy with democracy under centralized guidance can we enable all Party organizations and all Party members to take the initiative and demonstrate their creativity. Only by so doing can we pool the wisdom of the entire membership, guarantee that the Party's policy decisions will be correct and carried out effectively and make sure that it will tighten its discipline, increase its fighting capacity and advance our cause.

We should enhance inner-Party democracy and institute more systems as necessary to protect the democratic rights of all Party organizations and members. Channels for inner-Party democracy must be cleared and widened, so that Party organizations will be promptly informed of the opinions, suggestions and criticisms of the members. In inner-Party activities we should carry on the fine tradition of speaking the truth and matching our deeds to our words. We should also encourage Party members to express their views, and we should protect their right to do so, as set forth in the Party Constitution. We must identify and deal with anyone who infringes upon the democratic rights of Party members, suppresses criticism, retaliates against those who dare to criticize or tries to frame others.

Party committees at all levels must maintain and strengthen the Party's collective leadership. If a Party member has differing views, he may preserve them, but he must abide by the decisions made by the collective. We must see to it that the organizational principle of the Party is adhered to — the principle that individual Party members are subordinate to the organization, that the minority is subordinate to the majority, that the lower Party organizations are subordinate to the higher ones and that all the constituent organizations and members of the Party are subordinate to the National Congress and the Central Committee. We must not tolerate liberalism or any defiance of organization and discipline, such as going one's own way in disregard of orders and prohibitions. We must tighten Party discipline and keep a constant watch on the way it is maintained. All Party members are equal before Party discipline; anyone who violates it must be subject

to disciplinary measures. Our objective is, as always, to create a political situation in which there is both centralism and democracy, both discipline and freedom, both unity of will and a relaxed and lively atmosphere.

The Party's unity is its life. At this critical time when we need to speed up the reform, the opening to the outside and the modernization drive, it is particularly important for the comrades of the entire Party to close ranks on the basis of the Party's basic line. Every Party member, especially every leading cadre, should conscientiously work to safeguard Party unity and the authority of the Central Committee. They should all be in agreement with the Central Committee on ideological and political matters. We must never permit anyone to attempt to undermine and split the Party. Both central and local Party committees should hold democratic meetings regularly. Members of leading groups should trust, support and understand each other and engage in criticism and self-criticism. They should co-operate with each other to make their work a success. Leading cadres at all levels should set a good example by adhering to principle, observing strict discipline, protecting the interests of the Party as a whole and strengthening unity. So long as the Party remains vigorous and united in struggle, our cause will surely triumph.

To strengthen Party building and improve Party leadership, the 13th Central Committee presents for the examination and deliberation of this National Congress the draft of a revised Constitution of the Communist Party of China. This draft includes in the Constitution the theory of building socialism with Chinese characteristics and the Party's basic line. This is of great importance to ensure that there is unity of understanding and action throughout the Party and that we continue to advance along the path to socialism with Chinese characteristics.

Since it was founded ten years ago, the Central Advisory Commission has done much fruitful work. It has helped the Central Committee to preserve Party unity and social stability and to promote the reform, the opening up and the modernization drive, thus making historic contributions to the Party, the state and the people. The Central Advisory Commission now presents to this National Congress a proposal that the commission be abolished as of this congress.

Comrades,

To accomplish the reunification of the motherland is in the fundamental interest of the Chinese nation, and it is the common aspiration of the entire Chinese people, including our compatriots in Taiwan, Hong Kong and Macao and those

residing overseas. We shall work steadfastly for the great cause, adhering to the principles of peaceful reunification and "one country, two systems". The Chinese government will continue to co-operate with the British and Portuguese governments to ensure that the transfer of power in Hong Kong and Macao proceeds smoothly and that the two regions enjoy long-term stability and prosperity. Taiwan is an integral part of the sacred territory of China. We resolutely oppose in any form the notion "two Chinas," "one China, one Taiwan," "one country, two governments" and any acts aimed at bringing about the independence of Taiwan. We shall continue to work for direct links for postal, air, and shipping services and trade between the two sides of the Taiwan Straits and to promote people-to-people exchanges and co-operation in various fields. In particular, we shall work for greatly expanded economic co-operation between the two sides in an effort to revitalize the economy of the whole nation.

We reiterate that the Chinese Communist Party is ready to establish contact with the Chinese Kuomintang at the earliest possible date to create conditions for talks on officially ending the state of hostility between the two sides of the Taiwan Straits and gradually realizing peaceful reunification. Representatives from other parties, mass organizations and all circles on both sides of the Taiwan Straits could be invited to join in such talks. On the premise that there is only one China, we are prepared to talk with the Taiwan authorities about any matter, including the form that official negotiations should take, a form that would be acceptable to both sides. We hope that the Taiwan authorities will comply with the wishes of the people and help remove the artificial obstacles to the reunification of the motherland, so as to make it possible for relations between the two sides to enter a new stage of development.

Comrades,

Socialism is a completely new social system in the history of mankind. It is bound to replace

capitalism — that is the general trend of social and historical development. Any new social system, as it is born, consolidated and developed, inevitably follows a zigzag course involving a succession of struggles and sacrifices, of victories and defeats. Communists and the people in general will surely be tempered in this process and draw lessons from it, pushing socialism in the right direction. Thanks to the united efforts of all the Party comrades and the people of all our nationalities, socialism is flourishing in China. China is a huge country with 1.1 billion people, and the Chinese Communist Party is a great party with 50 million members. There is no doubt that the vigorous development of socialism with Chinese characteristics will make an important contribution to socialism and to human progress worldwide.

The period between now and the middle of the next century will be a most important and precious time for making our country prosperous and for advancing socialism. We have difficult tasks to accomplish, and we bear grave responsibilities. In the 1990s we must establish a preliminary new economic structure and attain the objective of the second stage of development: a relatively comfortable level of life for all our people. In another 20 years, when we mark the 100th anniversary of the founding of the Party, a whole set of more mature and complete management systems will have taken shape in every field of work. Thus, in the middle of the next century, when we celebrate the 100th anniversary of the founding of the People's Republic of China, we shall have attained the objective of the third stage: the basic realization of socialist modernization. The comrades of the whole Party and the people of all our nationalities must unite more closely under the leadership of the Central Committee. Sharing weal and woe, and with all hearts beating as one, we must hold high the great banner of socialism with Chinese characteristics and forge ahead courageously toward the magnificent goal! ■

Appendix II

A. Guidelines for Stabilizing the Economy

(Excerpts of the Presidential Reform Plan in 1990 in the Former Soviet Union)

BASIC GUIDELINES FOR THE STABILIZATION OF THE NATIONAL ECONOMY AND THE CHANGEOVER TO A MARKET ECONOMY—As Approved by the USSR Supreme Soviet on Oct. 19, 1990. (Izvestia, Oct. 27, pp. 2-5. 18,000 words. Excerpts:) ...

1. THE CHOICE HAS BEEN MADE

There is no alternative to changing over to a market system. The entire experience of the world has proven the vitality and effectiveness of a market economy. The transition to a market economy in our society is dictated entirely by the interests of man, and its goal is to create a socially oriented economy, to turn all production toward the meeting of consumer needs, to overcome shortages and the disgrace of making people wait in line, to provide genuine economic freedom for citizens, and to establish conditions that encourage industriousness, creativity, initiative and high productivity. ...

These basic guidelines are meant to serve as the foundation for coordinated actions by all the republics and Union agencies to stabilize the national economy and make the changeover to a market economy. In this connection, each sovereign republic will have the opportunity to work out and implement a set of concrete measures for the transition to a market system, taking into account its specific social and economic situation and its own national and historical factors.

2. ECONOMIC RELATIONS IN A UNION OF SOVEREIGN REPUBLICS

Economic relations among sovereign republics will be based on a recognition of the state sovereignty and equality of the republics and, at the same time, of the integrity of the Union as a federation, with the understanding that the enterprise is the foundation of the economy and the task of the state is to create the most favorable conditions for its operations. ...

3. THE LOGIC AND STAGES OF ECONOMIC RECOVERY AND THE CHANGEOVER TO A MARKET ECONOMY

... This difficult path needs to be traveled in as short a time as possible. Experience with stabilization programs in other countries and the calculations and forecasts that have been made with respect to our conditions show that this period may last approximately one and a half to two years. And it is for this period that the additional powers granted to the country's President are intended. ...

The tasks of stabilization of the economy and the changeover to a market system are to be carried out in four stages.

Stage I—The Program of Emergency Measures

At the very outset there will be an announcement of the introduction of legislative acts that will reinforce the basic principles and guidelines of the economic reform, and, most importantly, a system of measures to stabilize the national economy will be initiated, bringing about:

an improvement in finances and monetary circulation by reducing the state budget deficit, curtailing the emission of money, restructuring the banking system and putting enterprise finances in order;

protection for the public's monetary savings by increasing interest rates at savings banks; a balancing of the public's income and expenditures; support for the production of consumer goods; and, on that basis, a restoration and normalization of the consumer market;

stabilization of reciprocal deliveries and prevention, to the extent possible, of a decline in production;

destatization and privatization of property, and implementation of a land reform;

stabilization of foreign-economic ties.

The most difficult thing at this stage is to restrain the price rise that has begun: to limit the growth in wholesale and purchase prices, to implement a gradual increase in state prices for fuel, raw materials and building materials, and to control the level of state retail prices for mass-consumption goods. All this will have to be done in such a way as, on the one hand, to cover the budget deficit, which is growing because of the rise in purchase and wholesale prices, and on the other, to prevent runaway inflation, while at the same time improving the conditions of the commodity-money balance for an accelerated transition to a market system in the subsequent stage.

Stage II—Strict Financial Limits and a Flexible Price Formation System

The basic content of this stage is the consistent and gradual transition to market prices for consumer goods and for a wide range of products used for production and technical purposes. The measures taken at the previous stage should prevent excessive increases in these prices. In the future, inflationary processes are to be held in check by means of strict financial and credit policies.

At this stage firm state prices will be retained for at least one-third of all goods—fuel and raw and other materials—which is important for regulation of the overall price level and the level of state retail prices on essential consumer goods, prices that will determine the definition of a subsistence income for the population.

At the same time, the scale of destatization of property will be expanded, there will be privatization of small enterprises, and the market infrastructure will be developed.

Special measures will be taken to redistribute capital investments and other resources in favor of industries that work for the public, and incentives for their development and expansion will be strengthened.

The initial result of the emergency measures and the liberalization of prices will be seen in the form of a marked improvement in the consumer-market situation, especially with respect to goods that sell at prices determined by supply and demand. The stricter and more consistent the implementation of measures in the area of financial and credit policy and of measures to eliminate overheated demand, the lower the rise in prices will be. Goods will become readily available. This is the first positive result that can come from the reform, and it absolutely must be achieved.

During the transitional period, special mechanisms will be introduced to provide social protection for the public's income, including the indexing of income to the dynamics of retail prices. At the same time, measures will be initiated to provide support for socially vulnerable segments of the population.

In this connection, republics and local bodies of power can apply various measures to regulate prices, including a temporary price freeze on mass-consumption goods in the event that these prices rise excessively, can introduce rationed distribution of a number of goods, with compensation paid from their own budgets to producers and the trade sector for related losses, and can provide social protection for the public's income.

With the aim of maintaining production and economic ties, a state contracting system will be set up to assume responsibility for the placing of state orders on a contractual basis, and for the distribution of products supplied under state orders and the regulation of prices for those products.

Stage III—Formation of a Market

The main goal of this stage is to achieve a basic stabilization of the market for both consumer goods and means of production, while expanding the sphere of market relations and establishing a new system of economic ties.

Contradictory processes will be at work in the economy at this time. On the one hand, one can expect increasing saturation of the market with goods. The market infrastructure will develop at an accelerated pace, and the effect of entrepreneurial activity on economic activity will grow. The utilization of material resources should become more economical, and production stocks will decline. The resources that are freed up will augment the producer-goods market and promote its stabilization.

At this stage the emphasis will be on the formation of a housing market, the implementation of wage reforms, the restructuring of relations between enterprises and local Soviets in the social sphere, and the further liberalization of prices.

The creation of a housing market is an essential element of the changeover to a market economy. It will make it possible to put into circulation one of the most important commodities, one that is capable of absorbing a significant portion of the public's effective demand, thus serving to balance the consumer market and strengthen incentives for labor activity.

There is also a need to restructure the wage system. The main idea here is to eliminate regimentation and establish a state minimum wage—for all enterprises, regardless of their form of ownership—based on a minimum consumer budget, calculated with a view to the new level of expenses for housing and, in general, for the expanded range of goods and services that can be acquired at personal expense at market prices. A realistic minimum wage will be an important means of social protection for working people. At the same time, restrictions on opportunities to earn money will be removed.

In tandem with these measures, as economic conditions permit, republics and local bodies are to develop efforts to remove from enterprises the excessive and unevenly distributed responsibility for maintaining facilities in the social sphere. This will make it easier for enterprises to enter into market relations and will enhance their ability to compete.

With the successful implementation of measures from the previous stages, practically all the basic conditions needed for the stable functioning of the economy will be created: balanced prices and budget, a saturated market for consumer goods and services, a modern banking system and a foreign-currency market.

The conditions that develop after implementation of the housing reform will promote the formation of a labor market. Trade unions will gain a stronger position as defenders of the working people's interests, and unions of entrepreneurs and managers will be formed. On the basis of agreements among them, with the state playing a regulating role, the opportunity will be created for the organization of a labor market and for public control over the dynamics of income and prices.

As competition, entrepreneurial activity and price stabilization develop, financial and credit restrictions will be removed. A change in taxes and interest rates for credit will be introduced so as to stimulate business activity and increase investments.

Stage IV—Completion of the Stabilization Period

The basic tasks of this period are to reinforce the stabilization of the economy and finances, to improve the consumer market and, in particular, to speed the rate of formation of the competitive market environment needed for the full-fledged functioning of the self-regulating mechanisms inherent in a market.

During this period there needs to be significant progress

in demonopolization of the economy, destatization and privatization.

The preconditions must be created for an increase in the level of economic activity, particularly in light industry and the food industry, the agrarian sector and the service sphere.

A preponderance of prices based on supply and demand, combined with a balanced budget, will create the necessary conditions for resolving the key problem in the changeover to a market economy—the problem of internal convertibility of the ruble. The essence of the problem is to enable all domestic enterprises and foreign companies operating on USSR territory to buy and sell freely, at market rates, the foreign currency needed for current business operations.

The internal convertibility of the ruble will open up broad opportunities for an influx of foreign investments, which the country needs so badly for carrying out structural changes and retooling, and also for developing competition on the domestic market and overcoming monopolism. It can be said that, given the conditions prevailing in our country, this is an important prerequisite for engaging the market mechanism full-throttle. ...

4. MEASURES TO STABILIZE THE ECONOMY

... Putting finances and monetary circulation on a sound basis is the key task of stabilization. It involves eliminating the surplus of money in circulation, bringing the money supply in line with the supply of goods, and strengthening the ruble.

First and foremost, the Union and republic budget deficits must be drastically reduced starting in November-December of this year. In 1991, the aggregate budget deficit of the Union and the republics should not exceed 2.5%-3% of the gross national product (it should be no more than 25 billion to 30 billion rubles). That is the amount of deficit that can realistically be financed by floating loans among the general public, enterprises and organizations, and abroad. ...

Budget expenditures for the end of 1990 and for 1991 will be reduced by:

further cutting investments in production facilities...; cutting spending on the needs of the USSR Ministry of Defense and the State Security Committee, specifically by reducing arms purchases and military development. Some of the funds obtained by cutting expenditures are to be spent on raising the pay of military personnel and building housing for them. ...

Transforming the banking system and creating effective levers to regulate the money supply are of decisive significance for putting monetary circulation on a sound basis, preventing inflation and establishing stricter financial restrictions for enterprises.

To this end, specialized state banks are to be turned into joint-stock commercial banks operating on the same footing as other commercial banks. They will be directly responsible for meeting the economy's needs for credit and payment services. It is advisable to retain one state bank, which, with support from the budget, would offer credit on preferential terms to stimulate economic activity in the interests of the state. The Savings Bank will retain the status of a state bank, and the state will guarantee the integrity of deposits, if necessary by indexing them.

The USSR State Bank, the republic central banks, and their institutions will be given the functions of a reserve system with a single management body that will establish uniform, agreed-upon, universally binding rules for regulating credit and the money supply, including reserve requirements for commercial banks, discount rates, etc. The [state] monopoly on the emission of money will be maintained, as will a unified set of banking-oversight principles. ...

Enterprises will experience financial difficulties in connection with the implementation of these measures. To facilitate their adaptation to the new conditions and give them

an opportunity to accumulate their own working capital and find ways to increase their efficiency, plans call for the following measures: as a first priority, destatizing such enterprises, turning them into joint-stock companies and breaking them down into smaller units;

creating stabilization funds;

developing commercial credit among enterprises as an element of the new wholesale market, so as to lessen the orientation toward bank credit;

encouraging the practice of issuing bonds to augment working capital;

shutting down hopelessly inefficient enterprises. ...

The stabilization funds will be formed from special-purpose budget allocations, enterprise payments, a portion of the proceeds from the sale of state property, the sale of bonds, and other sources.

Financial assistance from the stabilization funds will be provided on specific terms that may include requirements to reorganize the enterprise, replace the management, reduce unproductive expenditures, change the line of business, split up the enterprise, etc.

Normalization of the consumer market is the most important part of the stabilization program from a social standpoint. To achieve it, on the one hand, an effective use must be found for the huge surplus of money that the public has accumulated, and on the other hand, the volume of goods and services reaching the consumer market must be increased.

To accomplish the first task, it is proposed that the sphere of purchasable goods and services be expanded. The sale of housing, dachas, building materials and various kinds of state property to the public is to be increased, and fees are to be charged for the long-term leasing of plots of land in the country. By redistributing construction capacity and giving construction organizations additional incentives, an additional quantity of residential rooms and garages will have to be built and several million out-of-town plots of land will have to be prepared as early as 1991, so that they can be sold to the public.

There are also plans to borrow money from the public at no interest, to be paid back in the near future (at fixed terms) with material benefits and goods in short supply—automobiles, personal computers, furniture, phone service, additional housing, garden sheds, garages, out-of-town garden plots and others. ...

Demonopolization and privatization are under way in retail and wholesale trade and the food- and consumer-service sectors, as well as in a significant percentage of the enterprises that supply them with goods. ...

If necessary, rationed distribution of a limited selection of essential goods will be used at the city, regional or republic level.

Guaranteeing the stability of economic ties is especially important in the transitional period, considering the unstable nature of the emerging market-based ties and the danger of production's being thrown into disorder.

In accordance with the USSR President's Decree, existing economic ties will be maintained in 1991, and severe sanctions will be imposed for breaking them. ...

Strengthening the USSR's foreign-economic position urgently requires that the country's hard-currency situation be normalized and foreign capital be attracted as quickly as possible. To create the conditions for this, there must be: a) a clear-cut program for stabilizing the political and economic situation, a program that enjoys the support of the republics and the country's main public forces; b) a national program for cutting back military spending, the Army and weapons and converting military production; and c) a new doctrine of foreign-economic ties, with guarantees for foreign investments.

If these programs are adopted and implemented, there is a possibility of:

receiving various forms of assistance from developed capitalist countries, including long-term loans on favorable terms;

with the concurrence of the appropriate Soviet of People's Deputies, leasing individual fuel and raw-material deposits and tracts of forest land, and organizing joint ventures for the complete processing of these natural resources with due regard for modern environmental requirements;

auctioning off or leasing real estate, including unfinished construction projects;

having the state sell foreign investors securities with various types of backing and stocks of USSR enterprises and organizations;

beginning to process, with the help of foreign capital, the numerous dumps and storage sites for wastes and secondary materials;

annually attracting foreign investments in the organization of joint ventures;

promoting the investment of foreign capital in the development of a modern tourism industry and business infrastructure. ...

Talks with the International Monetary Fund, the European Communities and leading foreign states on financial and economic support for the process of restructuring and market reform are nearing completion;

starting Jan. 1, 1991, accounts with CMEA countries will be settled at world prices and in freely convertible currency;

the USSR's economic assistance to foreign states is being cut back and put onto a commercial basis.

It is intended that the USSR Supreme Soviet set a ceiling on the USSR's foreign debt every year and approve the budget for assistance of this type. ...

It is important that decisions be reached as quickly as possible on questions of enterprises' right to mortgage land and property, thereby opening a way for them to obtain secured loans from foreign banks for the purpose of expanding their exports.

5. MEASURES FOR THE FORMATION OF A MARKET ECONOMY

Support for entrepreneurship, destatization, privatization and the development of competition. ...

It is planned in the near future to declare freedom of economic activity and of the development of entrepreneur-

ship in the country, establishing freedom for a variety of organizations and citizens to engage in economic activity, allowing for the creation of enterprises and for their registration on the basis of a simple statement, and stipulating the impermissibility of interference by state administrative bodies in the work of enterprises, regardless of their form of ownership and management.

The plan is to put these provisions into effect by means of a Decree of the USSR President. ...

At the same time, lists of types of activities that are prohibited, are the sole prerogative of the state, or are allowed only after obtaining a state license will be confirmed at the Union level and in the republics. ...

Destatization programs will be pursued with the adoption, at the Union and republic levels, of appropriate decisions in the form of Decrees of the USSR President and the highest bodies of power in the republics. ...

The USSR State Property Fund will be in charge of all the concrete work of destatization at the Union level. Similar agencies will be created in the republics.

Priority destatization and privatization measures are to be carried out first and foremost in those areas where it makes the most sense for nonstate structures to be in operation. These include trade, public food services, consumer service operations, and repair and construction organizations, as well as small enterprises in other sectors. At the same time, efforts will be made this year to convert large and medium-sized enterprises in different branches of industry and other spheres into joint-stock companies. ...

Approximately 90% of all property is owned by the state.

Therefore, the destatization process could be a long-drawn-out one. Various methods of speeding it up will be sought and tested, taking into account the interests of all citizens. ...

Land reform and the distinctive features of forming market relations in the agro-industrial complex. The key areas in the formation of a market economy in the agrarian sphere are:

- implementation of land reform and the creation of conditions for the effective functioning of various forms of ownership and management, elimination of the monopoly on land ownership, and the formation of an economy in the agrarian sector that is based on a variety of socioeconomic arrangements;

- elimination of administrative structures for the state management of agricultural production, and rejection of administrative establishment of mandatory orders for agricultural output;

- enhanced prestige and improved motivation for peasant labor, every encouragement of enterprise, and healthy competition among goods producers;

- the development and implementation of special-purpose programs for developing the production-related and social infrastructure in the countryside, with financial support from the state;

the ensuring of a social policy that corresponds to the needs and requirements of rural residents, and the creation of social and economic guarantees of a fitting position for the peasantry in society. The republics will adopt land codes and other direct legislative acts regulating land relations with regard for the special features of individual regions of the country, set conditions for granting land to everyone who wants it and is capable of utilizing it effectively for agricultural production, and determine the procedures for an employee to withdraw freely from a state, cooperative or other enterprise (association) with an allotment of land and a share of the property that has been accumulated, provided that he organize independent agricultural production. ...

The highest bodies of state power in the republics are to create land reform committees and assign them the task of inventorying and assessing agricultural lands, identifying lands that are not being used efficiently, regulating land tenure and performing consultative and oversight functions.

Work is to be done to transform inefficient collective farms and state farms by turning either all or part of their lands over to cooperatives, leaseholders, peasant farms, and industrial or other enterprises in order to set up agricultural commodity production, and also to conduct personal auxiliary farming and collective fruit and truck farming operations. ...

Price formation policy. Free market prices are an integral element of a market economy. To make the transition to such prices less painful, especially where prices for consumer goods and services are concerned, it is proposed that they be freed gradually from administrative control. In the initial stage, controls will be removed on prices for a group

of nonessential goods.

At the same time, with the aim of providing social protection for the population, it is planned to maintain state prices for the goods and services that form the basis of the minimum subsistence level for families (the republics will determine a basket of foodstuffs and manufactured goods for this purpose). ...

It is proposed that, as of 1992, price controls be maintained only for a narrow range of essential consumer goods (certain types of bread and grain products, meat and dairy products, certain types of fish, vegetable oil, sugar, medicines and some medical articles, special goods for disabled people, school textbooks, certain children's articles, some transportation rates, and rates for a number of municipal services). ...

In the event that decontrolled prices rise at an excessive rate, a temporary price ceiling can be set by a decision of republic and local bodies.

During the transitional period the state cannot all at once abandon the policy of maintaining low retail prices for various goods and, consequently, price subsidies. There needs to be a fundamental change in the way that price subsidies for goods are paid, however, so it is profitable to produce and sell these goods and, consequently, inexpensive goods do not suddenly become scarce. ...

It is proposed that prices for fuel-and-energy and raw material resources and some types of products in mass demand that are exchanged among republics be set on the basis of a multilateral agreement among the republics, taking into consideration suggestions from Union agencies, so the enterprises can be informed of these prices as quickly as possible. It would be a good idea to provide for a gradual increase in the prices for fuel-and-energy and other resources, which would make it possible to avoid sharp jumps in production costs and prices in other sectors, and would provide some time to implement resource-conservation measures. ..

Reform of the banking system. A solid ruble is the key to accelerating the economic reforms. A unified monetary system and the preservation of centralism in monetary and credit policy are a condition for strengthening it.

This requires the earliest possible reorganization of the USSR State Bank, with a view to giving it the functions of a reserve system. To this end, a supreme body of management of the USSR State Bank is being created—a Central Council, which includes the Chairman of the USSR State Bank, who is appointed by the USSR Supreme Soviet, and the directors of the republics' central banks. As the country's central bank, the USSR State Bank will retain its monopoly on the emission of money and determine common general principles for banking oversight.

The need for adopting such a banking system in the country is tied to the need for centralization of monetary and credit policy in the context of sovereign republics and the formation of a renewed federal Union on the basis of such republics.

Under this approach, the republics will adopt their own banking laws, provided they are not at variance with Union legislation on banks and banking.

The main condition for the USSR State Bank's performance of the functions of a reserve system will be its rejection of unilateral actions to regulate or limit monetary circulation and credit. In the republics, the central banks will be removed from direct government jurisdiction and will present annual reports to the Supreme Soviets, which will not interfere in their current operations.

Commercialization of the specialized state banks is an element of the credit reform. They will be transformed into independent joint-stock companies with as broad a distribution of shares as possible.

Commercialization assumes that banks will operate within the limits of their own resources and the resources invested by others, that they will be able to choose independently to whom they wish to extend credit and will be able to set prices and terms for the credit, that there will be a single

unified system of taxation and regulation for all banks, and that clients will be free to choose their own bank. ...

The State Insurance system is to be reformed over the course of several months. State Insurance agencies will be transformed into commercial institutions on a stock-holding basis, and the creation of new insurance companies will be permitted, including ones with foreign participation. A system of state insurance oversight will be organized. Insurance resources will no longer go into the state budget.

State regulation of banks will consist of supervision of their activities from the standpoint of protecting clients' interests. The central banks of republics will be assigned the task of registering the opening of banks, supervising their operations and their accounting and reporting procedures, and creating mechanisms—financed with fees paid by the banks themselves—for protecting the interests of commercial-bank depositors.

Under the conditions of the changeover to a market system, monetary and credit policy takes on fundamentally new characteristics. With the aim of bringing order to monetary circulation and credit operations, a transition is to be made: from credit and cash planning to regulation of the total volume of money in circulation. The key task of the first few months is to reduce credit sharply and to limit the growth of the money supply.

removal of some of the funds in banks and the deposit of those funds in the central bank will be at the center of the system of monetary and credit regulation at the initial stage. By changing the norms for reserve requirements, the Reserve System will be able to regulate the credit resources of commercial banks and, consequently, exert an influence on the volume of money in circulation and on inflationary processes.

Interest policies will be just as important. For the first three to six months, a new interest-rate structure will be introduced by administrative means (long-term rates higher than short-term, loan rates higher than deposit rates), with a significant increase in average interest levels, which should limit demand for credit and reduce noncash additions to the money supply.

A rediscounting system will be put into operation—the money collected from banks by various methods will be loaned to them at an interest rate set in keeping with the goals of monetary and credit policy; thus, banks will be forced to set their interest rates in accordance with the central bank's rate (it is to be the same for all members of the Reserve System).

The ruble must be given the status of the sole legal tender on the territory of the USSR. For the purpose of stabilizing the ruble's purchasing power, the issuing of other monetary units and surrogates and the use of foreign currency as a means of payment will be prohibited.

Restructuring foreign-economic activity. The changeover to a market requires the formation in the USSR of an open-type economy that develops in interaction with the world economy and in competition with it. Therefore, the Basic Guidelines proceed from the assumption that the country's customs territory, currency system, principles of investment policy and foreign-economic policy must be unified, with expanded authority for the Union republics in these areas. A statewide agency for managing foreign-economic ties, with direct representation of the Union republics, will be created to achieve this.

Under the conditions of the transition to a market system, the enterprise will become the principal figure in foreign-economic activity. Plans call for destatization and decentralization of foreign-economic activity—for shifting commercial operations to the enterprise level and ensuring their operational independence, while focusing the work of

state agencies on regulating these operations and providing incentives for them.

Petroleum, natural gas, gold, diamonds and precious stones, specialized technology, and possibly several other types of goods on a list compiled with the Union republics' concurrence will be considered Union-level export resources and are to be sold under special conditions.

Departmental foreign-economic associations will be transformed into middleman firms, including joint-stock companies, and where necessary will be broken into smaller units and diversified.

With the aim of encouraging and organizing foreign-economic activity:

new customs and foreign-currency legislation will be adopted in the form of norms with direct applicability; principles for new investment legislation will likewise be adopted;

differentiated foreign-currency coefficients will be abolished;

as of Jan. 1, 1991, foreign-currency earnings will be posted directly to enterprises' accounts; a portion of these earnings will be subject to mandatory sale to Union and republic budgets in accordance with norms that will encourage the export of manufactured goods;

in order to expand enterprises' independence in matters of foreign currency, an internal foreign-currency market will be created, with the free sale and purchase of currency at market rates; republic banks and some commercial banks will participate in foreign-currency and credit operations; enterprises will be authorized to act independently in attracting foreign credits, using their own property as collateral;

before March 1991, insurance systems are to be created to protect enterprises against foreign-economic risks, a Union system of foreign-economic information is to be introduced, and state certification of "business schools" and consulting firms is to be conducted for the purpose of improving the quality of business training and services.

Management of the foreign-economic complex is to shift primarily to the use of legal and economic levers (customs duties, exchange rates, bank interest rates). A new USSR customs tariff will be introduced to regulate foreign competition on the domestic market. The number of export goods subject to centralized licensing will be reduced to a minimum. ...

Measures to eliminate the shadow economy. Changing over to a market system is the most effective way to eliminate the shadow economy.

Basic measures to eradicate the shadow economy coincide with highly important areas of the reform. As world experience shows, more than 90% of the operations performed by a shadow economy can be eliminated fairly quickly with the aid of measures to establish a market. ...

6. SOCIAL POLICY DURING THE CHANGEOVER TO A MARKET SYSTEM

A socially oriented market economy, the creation of which is the aim of the Basic Guidelines, is an economic system in which each group and social segment of the population is given broad opportunities to realize its full potential and meet its needs on the basis of freely chosen employment and the growth of personal income.

For everyone employed in the economy, one of the most important and socially invigorating factors will be the opportunity to choose freely where and under what form of ownership and management they wish to apply their knowledge and experience. ...

The new economic system will provide an opportunity for people, if they are so inclined, to start their own business—to organize a cooperative, become the owner of a shop, restaurant or private taxi, or create a small enterprise or some other form of business.

Freedom to choose the forms in which one applies one's labor will become an important factor in improving living conditions for peasants as well. They will choose between a large farm—a collective or state farm—a small leasehold collective, or a small individual farm. Prospects will open up for rapid growth in the peasants' personal income, interest in which will be reinforced by an ever-increasing flow of goods from the cities. ...

Public consumption funds will be used to ensure all segments of the population a guaranteed level of social benefits that should be considered the minimum. As a rule, a higher level of consumption will be provided at no cost to citizens not yet or no longer able to work—children, the disabled and pensioners. All able-bodied persons will have to raise their standard of living primarily through their own labor and personal income. ...

Specifically, the following changes are being proposed in the current methods and instruments for applying social policy.

Wage reform. ... During the course of wage reform, state rates will be considered the guaranteed minimum wages for employees with the corresponding qualifications. From this perspective their application will be mandatory throughout the entire country and for all enterprises, regardless of their form of ownership. Republics and enterprises may at their own discretion set rates for wages to be paid from their own available funds, but these may not be lower than the state rates. ...

At the same time, a new system will be introduced for hiring enterprise managers on contract, in which the state rate will likewise serve as the minimum pay level.

All other questions concerning wages—forms and systems of wages, bonuses, awards, supplemental pay, etc.—are to be decided by the enterprises independently, without interference from state agencies. Individual wages will not be limited and will be regulated only by the income tax.

Stock dividends paid by enterprises and other earnings from property will be a new source of income. ...

Stepped-up social support for those unable to work and for students. The Law on Pensions for USSR Citizens, which will be implemented from 1990 through 1993, has now been adopted.

An important distinguishing feature of the new pension system is the way it is tied to a minimum consumer budget and the changing conditions of a market economy. Measures to change the pension system will make it possible to raise

the average size of pensions by approximately 50%.

As the effectiveness of the economy increases, there will be a further centralized increase in various subsidies tied to the birth and rearing of a child, and also for the disabled. There will be a substantial state-financed increase in stipends for students.

The republics may regard the centrally established levels for pensions, subsidies and stipends as minimum guarantees of material security for the categories of citizens in question. They have the right to increase the size of these payments if they can find the necessary funds. ...

The minimum consumer budget and a mechanism for social protection of the population against inflation. The minimum consumer budget index will be used actively as an important instrument in the implementation of the new social policy. Families whose average per capita income falls below the minimum subsistence level will receive priority assistance from local and state agencies.

At the same time, the basic form of assistance in the context of a market economy will be the creation of more favorable conditions for increasing personal earned income. Families in need of such help will be given priority in the allocation of land for the creation of a personal auxiliary farming operation or a peasant farm, will be granted credit on favorable terms, etc. And only in special cases will they be provided with direct material assistance and support.

The immediate introduction of such a minimum consumer budget does not seem possible at the present time. The problem is not merely one of a lack of funds. The country does not yet have normal conditions for an uninterrupted supply of goods to maintain such a budget—there are shortages everywhere in the consumer market, similar goods at varying prices are virtually nonexistent, the system of fee-based services is still undeveloped, and there is no free market of housing.

Therefore, at the initial stage, a minimum consumer budget based on a limited "basket" of consumer goods will be established for 1991. It will subsequently be revised with a view to the economy's capabilities.

The minimum consumer budget that is established will serve only as a starting point for the corresponding calculations in the republics, which will establish their own minimum consumer budgets with a view to local conditions.

There needs to be a system to protect income against inflation so that price increases do not worsen people's situations. The plan is to do this by means of various types of compensation, primarily by indexing incomes—that is, by increasing incomes in accordance with increases in the

of retail prices for the "basket" of consumer goods. This will be done with full disclosure of all relevant information.

The index will be set at 100% for pensions, stipends and subsidies, and at up to 70% for employees with fixed salaries and wage rates (military personnel, teachers, physicians, research personnel, office workers, etc.), taking into account the wage level. At economic-accountability enterprises, the wage fund will be subject to indexing.

The establishment of the minimum consumer budget and the procedure for indexing income will be regulated by legislation of the USSR and the republics.

Employment policy. ... Special state employment services will be set up under the local Soviets, not only to assist with job placement but also to aid in the creation of new jobs and in retraining and refresher training, offer vocational counselling and, finally, provide material support for people who find themselves temporarily without work. Local Soviets will organize paying public-service jobs for the temporarily unemployed. It is of fundamental importance that the employment service will provide its services to people free of charge. ...

To supplement the material support system now in place for people who find themselves without work, there are

plans to introduce direct unemployment benefits for cases in which, for some reason, it is not possible to place a person quickly or to obtain retraining for him.

Housing reform. A labor market that assumes the free movement of the labor force around the country and beyond its borders in response to supply and demand cannot function normally if there is no housing market.

The principles and conditions being developed, in accordance with the USSR President's Decree on that subject, for the implementation of a housing reform will be submitted for general discussion in the near future.

The social sphere under market conditions. With the transition to a market economy, one of the most important tasks is to provide support at the Union and republic levels for the nonmarket sector of the national economy, that is, for those sectors and types of activity that cannot, in principle, be geared to commercial criteria. These include a large segment of health care, physical fitness and sports, education, culture and the arts, environmental protection, basic science and so on. ...

This is the only sector of the economy in which, as a matter of principle, financial and other restrictions will not be applied even during the period of stabilization of the national economy. The budget for the social sphere will become the principal indicator of society's and the legislative branch's real attitude toward culture, education, public health, science and environmental-protection measures. ...

7. STRUCTURAL AND INVESTMENT POLICY DURING THE CHANGEOVER TO A MARKET SYSTEM

The creation of a modern-day structure for the economy is a necessary condition for the transition to a market economy and a prerequisite for the latter's successful functioning. The drama of the situation lies in the fact that the depth of the distortions that have developed nullifies any attempt to make the changeover to an economy based on market mechanisms if that attempt does not simultaneously make structural changes in the existing economy.

The key areas of structural changes are:

- the creation of a developed consumer-manufacturing sector of the economy as a necessary condition for the mobilization of social reserves for economic growth;
- elimination of the imbalance in the economy's technological structure as the principal reason for the perpetuation of a resource-squandering economy. ...

Conservation of energy resources is of extreme importance. The goal is to reduce losses, increase the thoroughness with which resources are processed, and on this basis bring about a stabilization of the volume of resource consumption for a period of five to 10 years. The practice of increasing the export of energy and raw materials must be rejected.

One can expect that a policy of restrained development of sectors in the fuel and power complex—a policy in keeping with a nearly stable domestic energy-consumption level—will make it possible in the future to hold down the annual increase in our country's capital investments in the fuel and power complex to a moderate level.

The production infrastructure—transportation, communications and the safekeeping of goods and equipment—should occupy a special place in structural and investment policies. Its current state not only could become a bottleneck in the formation of a market system, but also entails a threat to the functioning of the most important sectors of the national economy. Investments in this sphere must have the same priority as the production of consumer goods.

Straightforward assessments of possible cutbacks in areas where investment resources are used ineffectively... will make it possible to plan on a certain reduction—to the level of the 12th Five-Year Plan—in the level of investment in the economy's production facilities. At the same time, there will be increased capital investment in the implementation of social programs.

State scientific and technical policy. In the area of

science, the state will assume the financing of basic research and the maintenance of the structures needed to conduct it. ...

During the changeover to a market, scientific and technical potential must not be lost—particularly insofar as it ensures the development of areas of long-term strategic importance for the country. On the one hand, the principal criterion for economic measures aimed at the formation of market relations should be their influence in making production more receptive to scientific and technical achievements and in increasing incentives for creative initiative and entrepreneurial activity. On the other hand, it is necessary to strengthen the role of the state in maintaining and bolstering intellectual potential and in developing high-priority areas of scientific and technical progress, particularly during the transitional period.

The great bulk of applied research and development will be conducted on a commercial basis. ...

Conversion of the military-industrial complex. The conversion program must be developed as an overall national-economic program whose content is tied closely to all the elements of the strategy for structural transformations in the country's economy.

The result of its implementation will be the creation of new production facilities oriented toward meeting the economy's needs for civilian products. ...

Effective implementation of the conversion program can be ensured if the barriers separating the defense complex from the rest of the economy are removed. This is compatible with continued Union ownership and highly centralized management of the enterprises that are most closely involved in ensuring the country's defense capability. ...

Measures for state regulation of structural changes in the economy. The driving force behind the process of structural change in the economy should be economic initiative on the part of enterprises and entrepreneurial activity on the part of the public, activities that require effective legal and economic guarantees. With the aid of state regulatory measures, this powerful factor should be aimed first and foremost at saturating the consumer market.

Special state programs—particularly investment programs, both centralized and decentralized—have a special role to play here. ...

8. REORGANIZATION OF THE MANAGEMENT SYSTEM

The changeover to market relations and their effective functioning are possible only if there is strong and clearly organized state power. The experience of all countries that have created a developed market economy and a high standard of living for their people attests to this. ...

A decisive move must be made to new structures of state and economic management that are aimed at the formation of a market-type economy and that will ensure effective interaction among Union, republic and local bodies. The interests of the cause demand that the development and implementation of economic reforms and programs for the changeover to market relations be set aside immediately as a special function of state administration.

First of all, maximum use must be made here of the powers that were recently granted to the President of the USSR by the USSR Supreme Soviet. In this situation the role of the Council of the Federation should be expanded; it should work out and implement, through Union and republic bodies of power, decisions agreed upon by the republics. To this end, an Interrepublic Economic Committee made up of representatives of the republics, specialists and scholars is to be created under the Council of the Federation. ...

The vertical chain of authority of executive bodies should be restored immediately, so that republic governments and Soviet executive committees at various levels are subordinate to two bodies—to their respective Soviets of People's Deputies and to the higher bodies of executive power. Decisions made by the higher bodies within the limits of their authority are binding upon the lower bodies.

Things must be managed in such a way that new structures consistently and irreversibly replace bodies that do not meet the demands of a market economy. A dual task must be performed: Market-economy structures need to be formed and used to gradually replace the agencies of the administrative system, yet care must be taken not to get ahead of events—not to break existing ties without due regard for the creation of the necessary conditions in the national economy.

In the near future a number of Union and republic bodies will have to be created to perform new functions arising from the changeover to a market. A state contract system will have to be developed—a complex of organizations that place orders for goods to meet state needs, select contractors and prepare and conclude contracts. A USSR State Property Fund also needs to be organized, along with a State Inspectorate for Securities Oversight, a State Prices and Standards Inspectorate, a Regional Development Investment Fund, an All-Union Foreign-Currency Fund, an Economic Stabilization Fund, a Fund to Promote Employment, a USSR Antimonopoly Committee, a USSR State Insurance Oversight Agency, a USSR Pension Fund, a Committee to Promote Small Businesses and Entrepreneurship, and corresponding organizations in the republics.

Programs for the formation of stock exchanges, goods and commodities exchanges, insurance companies, auditing firms, holding companies, brokerage houses, commercial banks, trading houses, intermediary trading firms, commercial centers and companies, auctions, trade fairs, etc., need to be implemented on the basis of initiative and with the support of the state. ...

Coordinated efforts are needed on the part of all-Union, republic, local and economic-branch bodies, enterprises and associations to develop society's management potential, make fundamental changes in the work of training centers, personnel services and consulting and research services, and utilize new organizational forms for these purposes. ...

During 1991, no fewer than 180-200 territorial training centers and 1,200-1,300 training centers at major industrial associations and educational institutions need to be put into operation; textbooks and teaching aids on the market economy and the principles of entrepreneurial and managerial activities need to be produced; the physical facilities need to be created for the development and production, in cooperation with leading foreign firms, of audiovisual and computer-based teaching programs; and an extensive network of consulting support needs to be organized for management personnel and specialists. ...

New types of training that meet the needs of the market economy are being set up, cooperation with foreign partners is growing, and the practice of sending undergraduates, graduate students and doctoral candidates abroad for study is expanding, as is the creation of joint centers. It will become increasingly common for Soviet specialists to spend prolonged periods working and studying abroad, in some cases on the basis of individual contracts. ...

B. Man, Freedom and the Market

(Excerpts of Shatalin's Economic Reform Programme in 1990 in the Former Soviet Union)

AIMS: SHIFT PROPERTY FROM STATE TO PEOPLE, ALLOW FREE CHOICE; JOINT-STOCK FIRMS, PRIVATELY OWNED SMALL BUSINESSES; GRADUAL PRICE REFORM; JOBLESS AID; ECONOMIC UNION PACT FOR SOVEREIGN REPUBLICS

MAN, FREEDOM AND THE MARKET.—Izvestia Acquaints Readers With the Basic Ideas of the Program Worked Out by a Group Under the Leadership of Academician S. S. Shatalin. (Izvestia, Sept. 4, pp. 1, 3. Complete text:) **Editors' Note.**—The Russian SFSR Supreme Soviet has begun its discussion of the program for the changeover to a market that has been prepared by a group under the leadership of Academician S. S. Shatalin. This group, as is known, was formed on instructions from the President of the USSR in line with an accord among M. S. Gorbachev, B. N. Yeltsin, N. I. Ryzhkov and I. S. Silayev.

The group worked from Aug. 8 to 31 at the RSFSR Council of Ministers' Arkhangel'skoye vacation lodge outside Moscow, enlisting the cooperation of a large number of specialists and entire research collectives. The complete document, consisting of several hundred pages, constitutes a program for changing over to a market and forming the foundations of a market economy, taking into account the economic and political realities of our time. The drafters proceeded from the premise that the main burden of the changeover to a new economic system should be borne by the state, not by individuals. The market is being created to give people a better life, not, of course, to punish them at the hands of those who are just out to improve their own lot.

The drafters of the program have asked the editors of Izvestia to acquaint the public with some of its main ideas, so that people can understand, at least in general outline, what this program proposes, taking into account, naturally, that the forthcoming discussion and further work on the program will make some adjustments.

This program could appear only under the conditions of restructuring, and it lies entirely within the channel of the policy begun in 1985. M. S. Gorbachev and B. N. Yeltsin were the initiators of its preparation. It can be carried out only with their joint support.

As a result of many years of domination by a totalitarian social and political system, our society has ended up in a state of deep crisis. The indecisiveness of the government and the miscalculations it has made in economic policy have

brought the country to the brink of catastrophe. People's lives are becoming more and more difficult, and hopes for a better future are being lost. The situation can be overcome only by well-thought-out and energetic actions, supported by the people and grounded in their solidarity and patriotism.

Our society has accumulated a great deal of negative experience with economic reforms, which people now link only with changes for the worse in their lives. Unfortunately, life has taught us to believe more readily in the bad than in the good. Implementation of the proposed program should disprove this sad experience.

The program's main distinguishing feature is that it is grounded in a fundamentally new economic doctrine. Movement toward a market will be above all at the expense of the state, not at the expense of ordinary people.

An essentially antipopular policy was pursued for a long period: a rich state with a poor people. The state concentrated in its hands enormous resources, virtually the entire ownership of means of production. Resources were spent thoughtlessly on gigantic and inefficient projects, on building up military might and on foreign-policy adventures with an ideological underpinning, although all this has long been beyond our means.

The program sets the task of taking everything possible away from the state and giving it to people. There is serious reason to believe that the return to the people of a significant share of property and resources on various terms will ensure much more efficient and thrifty use of this property and these resources and will make it possible to avoid many negative phenomena in the process of changing over to a market. It is necessary to resolutely reduce all state spending, including spending on items concealed from society.

Only when all the possibilities and resources that are being devoured today by the gigantic state machine are turned to the needs of people and when people learn that this is being done, only then will the country's leadership have the right to appeal to the people to show patience, to bear the greatest possible burdens in the name of the homeland, in the name of their own future and that of their children.

We also should appeal to other countries for assistance. They will support us if they consider our program to be sufficiently resolute and well-crafted, if they are confident that the assistance they provide will be used sensibly and effectively for the good of people.

Each person, each enterprise and each geographic area or sovereign republic will see in the proposed program a response to its vital interests and will receive, with the program's help, an opportunity to act for the implementation of these interests right now, immediately.

This is yet another fundamental feature of the program: people do not have to wait for someone's permission or instructions, they can act in accordance with their own interests. The program shows how one can act best and most effectively along these lines. A person who reads this program with his own interests in mind can determine what is advantageous to him personally and decide ahead of time when and what he should do, what he should demand from whom, in what quantity and under what conditions, in order to exercise his economic rights and interests.

No one is imposing a kind or type of activity on anyone; everyone is free to choose for himself, gearing his choice to his desires and possibilities: whether to become an entrepreneur, a hired employee in state structures or a manager in a joint-stock enterprise, engage in individual enterprise, or become a member of a cooperative. The reform grants citizens the right of economic self-determination, establishing rules the observance of which will prevent certain entities (people, groups of people, enterprises or geographic areas) from securing their own interests by infringing on the economic rights of others. It is freedom of choice that is

the basis of people's personal freedom, the foundation for disclosing the individual's creative potential. These are still not the rules of the future market economy—they will emerge in the course of the formation and development of this society. The economic content of the proposed program is the changeover to a market, the creation of the foundations of a society with a new economic system.

The system of economic relations and management of the national-economic complex that currently exists in our country is to blame for the fact that in a very rich country industrious people live at a level that does not at all correspond to the wealth of the area or to their talents and efforts. People live worse than they work, because they either are not producing what they themselves need or what they do produce is lost or not used.

The proposed program outlines ways of changing over to an economic system that is capable of eliminating this situation and providing all citizens with a real opportunity to make their lives significantly better. Thus, the program can be regarded as a program for realizing citizens' rights to a better, more adequate life.

A Person's Right to Property.—The right to property is realized through destatization and privatization, through the transfer of state property to citizens. It is in the return of property to the people, first and foremost, that the social orientation of the economy is manifested. This is not an act of revenge but the restoration of social justice, a form of codifying a person's right to his share of the country's accumulated national wealth and of the wealth that will be created in the future. Privatization—and special emphasis should be placed on this—is a form of distributing responsibility for the condition and level of the development of society among all of its members who desire to take on this responsibility. Privatization should be absolutely voluntary and should not resemble collectivization in reverse.

Property in the hands of everyone—this is a guarantee of the stability of society, an important condition for preventing social and national upheavals. A person who has his own home and plot of land, which he can always transfer or leave to his children, a person who owns stocks or other financial assets, has an objective stake in the stability of society, in social and national concord. On the other hand, our sad experience shows how dangerous for society, for its normal life and development, is a person who has nothing to lose.

The program gives equal chances to everyone. However, this equality of chances should not be perceived as a mirror image of wage-leveling. In order to prevent privatization from turning into a means for the legal and excessive enrichment of the few, the procedure itself should ensure participation in privatization by very broad strata of the popu-

lation: Virtually everyone, even if he has no substantial initial capital, should be able, if he so desires, to obtain his share of the national wealth. Equality of opportunity will be ensured by a diversity of forms of privatization, which will make it possible to lease property, to buy it on credit, to acquire it on a joint-stock basis, etc.

It is a point of fundamental importance that the state cannot and should not give out its property free of charge. Property must be earned, since a person has little faith in or appreciation of property that he has received as a gift. At the same time, some state property should be considered as having already been earned by people, and it may be given to them free of charge or for a symbolic payment. What is involved here, above all, are long-occupied apartments with minimal living space per person, small garden plots, and many other things.

Immediately after this, work is to begin on the creation before the end of the year of 50 to 60 joint-stock companies based on large state enterprises, as well as the transfer or sale for a symbolic payment of certain (to all intents and purposes, already earned) categories of housing and plots of land.

An inventory is to be conducted of the country's national wealth, first of all its gold and currency reserves, strategic stocks, the property of public organizations, unfinished construction, the property of the Armed Forces and certain other types of state property (passenger cars, state dachas, etc.). Local (district and city) Soviets will conduct an inventory of nonresidential buildings. Local Soviets will also freeze a large number of production-facility construction projects on the basis of the results of the inventory of unfinished construction. The value of these projects, uninstalled equipment and stocks of construction materials will be estimated. This work will make it possible to begin to sell some stocks of materials to the population, enterprises and cooperatives.

Local Soviets will estimate the value of trade enterprises, consumer-service and local-industry enterprises, and small and medium-sized enterprises of other branches. After an analysis of the financial condition of these enterprises has been conducted, a list of them will be published in the press, indicating time periods and terms for their privatization. Then, with complete glasnost about the progress of privatization, the sale of nonresidential buildings and small enterprises—workshops, stores, service establishments, kiosks—will begin. The program is aimed at enabling people to use the money they have to acquire property. Shifting a significant part of demand to these purposes will also make it possible to avoid a substantial rise in prices as they are gradually "liberated."

At the same time, the local Soviets will conduct an inventory of land, taking into account the nature of its use. The implementation of these measures will make it possible to ensure access to land for all those who wish to engage in agriculture. Along with this, there will be an expansion of the allocation of land to gardening and orchard associations, with the sale of plots for a charge. In this process, already allocated plots up to a certain size will be sold for a moderate charge, while plots over the established size will be sold for their full market value.

The basic work load in realizing the rights of citizens to own property will rest with specially created privatization agencies and land reform committees under the province (district) Soviets of People's Deputies.

The right of citizens to economic activity is to be ensured by the redistribution of property between the state and citizens in the course of destatization, and also by the adoption of a Law on Entrepreneurial Activity. The state will create an economic environment that will facilitate the development of initiative and enterprise, will simplify as much as possible the procedure for opening one's own business, will help to organize it properly, and will support it with tax benefits and credits in competition with large enterprises. The program proceeds from the premise that small businesses are necessary to society in order to turn production toward satisfying the requirements of each specific person, to combat the diktat of monopolists in the consumer

and producer markets, and to create the necessary conditions for the rapid putting to use of new scientific and technical ideas, to which small and medium-sized businesses are the most receptive.

The Right of Citizens to Economic Activity.—How, technically speaking, will people's right to property be realized?

On the very first day of the beginning of the program's implementation, equal rights for all physical and juristic persons to carry on economic activity will be officially proclaimed. A program of privatization, the transformation of large state enterprises into joint-stock companies, and the sale of small trade, public-catering, consumer-service and other enterprises will be announced. This same statement will talk about granting guarantees of ownership rights to any type of property, except that which belongs exclusively to the state. An amnesty will be announced for those convicted under articles dealing with entrepreneurial activity, and these articles themselves will be removed from criminal and administrative legislation. At the same time, the struggle against crimes against citizens' property will be stepped up.

By legislative means, a favorable atmosphere will be provided for withdrawing enterprises from state ownership at the initiative of labor collectives that apply to the State Property Fund or republic Committees for the Management of State Property.

The state will provide incentives for the development of international economic ties and travel abroad for work or study. Attempts to construct a system fenced off from the outside world have virtually consigned most branches of our economy to degradation and stagnation. The opening up of the domestic market will make our country's entrepreneurs compete with inexpensive imported goods both within the country and abroad, which will give our economy dynamism and flexibility in satisfying the requirements of the market, and hence of the consumer.

The Right of Citizens to Freedom of Consumer Choice and Fair Prices.—Freedom of consumer choice holds a rather important place among the rights and liberties in the new economic system. The country's consumer market today has been destroyed virtually completely, and our consumers—that is, all of us—are, accordingly, without rights. The citizens of a great power have turned out to be hostages of empty stores, having, for all practical purposes, fallen under the power of goods-producing monopolists and goods-distributing monopolists.

Among the many reasons for this situation, in the front rank is the inflationary sums of money, not backed by goods, that have been paid to the population, mainly in the past few years. The constantly heard reproaches to the effect that people supposedly have a great deal of "surplus" money and that it must be taken away somehow are essentially immoral. Can we really consider as "surplus" savings that come to a little more than 1,500 rubles per capita? If we take into account citizens' personal property, which is meager for the most part, it is clear that the overwhelming majority of the possessors of "surplus" money are not far from the brink of poverty. Even the total sum of all the money that consumers are ready today to invest immediately in various goods is extremely small. But our consumer market cannot stand up to even this monetary confrontation.

The reform is aimed at normalizing the condition of the consumer market through liberalizing price formation. But during the transitional period this will be done by forming commodity reserves, including through import deliveries, taking into account the forthcoming stage-by-stage change-over to unrestricted prices for many types of goods. An unrestricted exchange rate for buying and selling foreign currency will be introduced, and a foreign-currency market will be developed. A number of large banks will receive the right to trade in foreign currency at market prices, and Soviet citizens will be permitted to keep foreign currency freely in banks.

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The opinion exists that the changeover to a market is impossible without an administrative price increase. The program makes it possible to begin this changeover without a centralized price increase. The market knows the rise or fall of prices, but the administrative system, especially in the past few years, has changed prices only in an upward direction. We can see from our as yet nonmarket economy that life is getting more expensive, and this is taking place much more quickly than the official statistics recognize.

Why should people have any confidence that the next price lists from the State Prices Committee will give prices that are fair or close to fair, when up to now such prices have not once been forthcoming from the State Prices Committee? Of course, there is no guarantee that free-market prices will be fair immediately, but sooner or later the market will establish fair prices, while administrative control and centralized management of prices will never do. Even when the government succeeds in administratively keeping low prices for one commodity or another (especially for goods in the short-supply category), all that the consumer can do, as a rule, is be content with the awareness that low prices do exist somewhere. For the most part, these goods are not available for sale, or they go to the privileged strata of the population. The greater part of consumers have for a long time been acquiring them on the market, including the "black" market, at much higher prices.

The changeover to unrestricted prices will be carried out step by step, beginning with commodities that are not prime-necessity consumer goods and are acquired largely by high-income strata of the population. Thus, the burden of price increases will fall on them first of all.

In accordance with the program, food products are to be differentiated by quality grade. Broad differentiation of prices for goods depending on their quality is to be combined with low prices for a range of prime necessities. The share of unrestricted prices will be increased step by step.

There are plans to organize courses and programs for the retraining and refresher training of workers and office employees and to form a system of volunteer-manned public works projects. The critical nature of the employment problem will be eased considerably by the creation of additional job slots at new production facilities, in trade and in the service sphere, and by providing incentives for the development of entrepreneurship and small enterprises.

The regulation of employment should ensure not the permanent assignment of a worker to a specific job but the creation of conditions for continuous growth in qualifications and occupational skills. It is the development of such a continuously operating mechanism and its improvement in accordance with emerging problems that will become the core of state employment policy.

The Right of Enterprises to Freedom of Economic Activity.—The economic freedom of enterprises consists in granting them the opportunity to operate in the interests of their employees, stockholder-owners and the state and in accordance with market conditions, to independently determine the volume and structure of their production, the volume of sales and prices for their output, and to choose their partners.

From virtually the very beginning of the program's implementation, enterprises will have the opportunity to change their owners: either through privatization (mainly for small and medium-sized enterprises) or through transformation into joint-stock companies (primarily for medium-

sized and large enterprises). Hence, right after the program is announced enterprise collectives can begin preparations and go through this process as painlessly as possible, a process that differs fundamentally from our practice of sending down such decisions like bolts from the blue. They will be able to resolve as they see fit the question of hiring highly qualified managers on contract.

With a view to maintaining economic stability, established economic ties will evidently be frozen until July 1991. However, after that enterprises will receive the right on their own to determine their product mix and production

volume and their customers and suppliers, and to organize the unrestricted marketing of output throughout the country.

Enterprises will withdraw from the system of branch monopolies and will have to establish horizontal ties with their partners. They will also be able to acquire material resources on the wholesale market, including unfinished construction, etc., to freely sell surplus equipment, stocks of materials and other property, and to lease out their fixed assets. They will be granted the right of direct participation in foreign-economic activity. Enterprises will be able to buy and sell foreign currency on a domestic currency market.

In acquiring new rights and expanding the sphere of their economic freedom, enterprises should take into consideration that the program proposes harsh restrictions for them: an increase in charges for credits, the reduction of budget subsidies to zero, a sharp decrease in state capital investments, a reduction in state purchases, and foreign competition. An awareness of these realities will help enterprises do a better job of dealing with their newly acquired freedom.

The Republics' Rights to Economic Sovereignty.—These rights are to be ensured, in accordance with this program, on the basis of a Treaty of Economic Union Between Sovereign States and a number of agreements supplementing it. The conclusion of agreements on interrepublic deliveries and on deliveries for all-Union needs, as well as on mechanisms of maintaining economic ties during the transitional period, is also proposed.

The main thesis in relations between the republics and the center is that no one is to direct or give orders to anyone else. The entire program is based on respect for the declarations of sovereignty adopted by the republics. It is impossible to conduct the economic reform on the basis of directives from the center, no matter how right they may be. The peoples will no longer put up with a situation in which fundamental questions of their lives are resolved at the center, without their participation. The program takes into account the rapid growth of national self-awareness, and therefore the principal role in implementing the transformations is assigned to the republic governments and local bodies of power. Power should be brought closer to people.

In exercising their rights to economic sovereignty, the peoples will receive an opportunity to dispose of the national wealth of their republics on their own, to prevent the senseless wasting of resources, and to preserve the environment and mineral wealth for coming generations. The republic governments now bear responsibility for the development of the territories under their jurisdiction and, accordingly, they are taking on a large part of the powers related to managing the economy.

The republics will determine the level of the basic taxes and the forms and methods of privatization, and they will regulate prices for most goods. Each republic will itself find ways to carry out land and housing reforms, and the republic governments will work out their own systems of social guarantees and form the republic budgets on their own. Money will be transferred to the Union to finance only those programs in which the peoples have a real stake.

The republics are to determine the extent of their independence in managing the economy and take upon themselves the handling of relevant types of state property. The ultimate goal of the demarcation of powers with respect to the management of state property is not simply its transfer from Union to republic jurisdiction but destatization and privatization. By an accord among all the republics, many types of property are to remain under all-Union ownership.

Economic integration is necessary, but it should be constructed not on a unitary basis and the diktat of the center but on a voluntary, mutually advantageous basis and equal partnership. In entering into an economic union, the sovereign republics will reach agreement on the general principles of economic policy, on the development of a single market,

and on the coordinated implementation of the reform. The union's administrative bodies will be formed on the basis of parity representation for all the republics. The formation of these bodies is to be planned at the very beginning of the program. The powers transferred to the union administrative bodies will be agreed upon by all the republics and codified in the Treaty of Economic Union.

Participation in the economic union should be advantageous to the sovereign republics, and therefore the voluntary nature of entry into the union and the right of free withdrawal therefrom must be stipulated. At the same time, a member of the economic union is to take on certain obligations agreed upon by all its participants. If a republic refuses to fulfill these obligations but wishes to participate in certain social and economic programs of the union, it receives the status of an associate member (observer), which constricts its rights within the framework of the union.

The Economic Rights of the Center.—These rights constitute the sum total of the rights delegated by the sovereign republics. Within the framework of these agreed-upon rights, the center exercises its powers with respect to the management of all-Union property and funds and all-Union economic programs, and it also ensures the maximum possible coordination in the implementation of the reform.

The Right of Society.—Our society has the unconditional right to live better right now, not in the distant future, and the proposed program for the changeover to a market economy is aimed at the fullest possible realization of this right.

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