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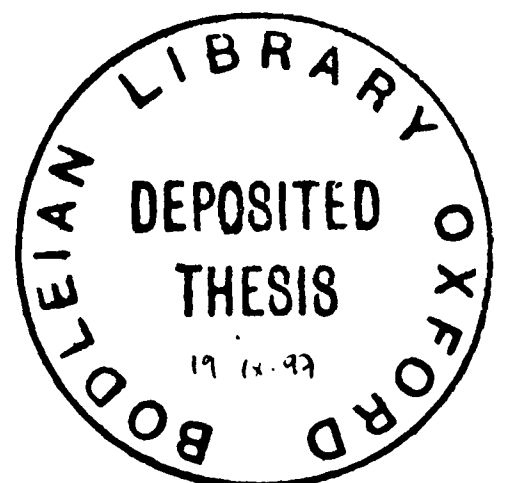
**Economic rationality and political viability, prerequisites in
economic reform?**

A case study of China 1978 - 1995

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May 1996



ABSTRACT

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To address the research questions - How has the Chinese government been able to produce a successful reform process and what logic has been behind it? - I develop a politico-economic framework that is largely based on a public choice model by Frey & Eichenberger (1992) and a politico-economic research methodology by Bates & Kreuger (1993). Its basic assumption is that all individuals, including bureaucrats and autocrats, maximise their own power and money subject to constraints. Secondly, it assumes that, when a new leadership rises to power, it will try to start an economic reform process in order to secure its power position. Per reform period, economic reform plans are analysed on their intended effect, implementation and actual results in pure economic terms as well as in political terms (leadership's power position). The framework hypothesises that during a reform process a government will perform a constant balancing act between the political viability with the economic rationality of each individual reform measure.

This hypothesis is tested to the Chinese reform period 1978 - 1995. The constraints Deng Xiaoping's leadership faces are the Communist Party's rule, a very strong bureaucracy, management of state enterprises and military, the command economy with an agricultural commune system and a revenue dependency on state owned enterprises. The hypothesis largely holds for China: agricultural reforms start with liberalisation to be later on largely retracted; real state owned enterprise reforms are never implemented; rural industrial reforms boom after tax revenues could be withheld at local level; the military's civilian industries is thriving. Unwanted results are quickly changed or retracted in the following period. Also identified is that despite these efforts, unintended interlinkage effects between the different reform measures become increasingly important and difficult to assess, resulting in a great loss of power for the leadership.

thesis length: approximately 50.000 words

ACKNOWLEDGEMENTS

The ideas behind this thesis started many years ago at my family's dinner table back home in Holland. Therefore, I first of all would like to thank my parents and brothers Gustave, Frans and Maarten not only for their invaluable support over the years, but also for their inspiration. The foundations of the theoretical approach were developed under the supervision of Prof. Sweder van Wijnbergen, during the final stages of my Doctorandus degree in Economics at the University of Amsterdam. I thank him for the challenge he offered me as well as his recognition of my achievements. It encouraged me to continue my research at the University of Oxford, and develop an analytical framework on economic reform. I would like to express my sincere gratitude to Dr. Barbara Harris, Prof. Dr. W. Brus and Dr. Frank Pieke who gave me at the most critical times both moral and academic support. Both Barbara and Frank stepped in at two of the most crucial stages of my thesis and I will always be especially grateful for the help and encouragement they gave at those moments as well as afterwards. Finally, I would like to thank Tordis Flath-Mackey, Fiona Ryan, Pily Palmer, Anne Marieke Ezendam, Helene Bootsma for their support and belief in me, and a special thanks to Edward Rumble, Justin Fielder and Ivo Westera; their friendship pulled me through.

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GLOSSARY OF ABBREVIATIONS USED

CD	-	China Daily
CSY	-	China Statistical Yearbook
Ec	-	the Economist
FEER	-	Far Eastern Economic Review
FT	-	Financial Times
IHT	-	International Herald Tribune
NRC	-	Dutch quality newspaper
PLA	-	People's Liberation Army
SCMP	-	South China Morning Post
SOE	-	state owned enterprise
SWB	-	BBC World Broadcast Services, Far Eastern issues
tvce	-	township and village collective enterprises

Introduction

In this last decade, the results of the economic reform processes in developing countries, and more recently in some of the transition economies, have more often than not led to a decline in living standards for ^{its citizens} the countries involved and a further breakdown of their ^{+ society} economies. The ones that seem to have been able to come out of this situation, most notably some of the Asian countries, have done so via their own interpretation of economic reform. ^{as opposed to} ^{World Bank}

Both the success of some and the failures of most others have made the Western world and the international institutions aware that their economic adjustment programs and economic advice have tended to meet with limited or no success in three aspects: the economic conditions only improve slightly; in (semi) autocratic states repression of the population by their rulers often increases; conditionalities which the governments formally accepted are fulfilled to a small degree only and many programs are abandoned after a relatively short period.

China has been among the countries that followed its own reform path. It did not implement any adjustment program, nor relied much on foreign advice (Jacobson & Oksenberg, 1990, p.140). The contents of its economic reform plans and the sequencing of the individual reform measures deviated extensively from what according to the orthodox economic theory should have been done. In 1978, Deng Xiaoping introduced a package of new reform measures at the 11th Communist Party Congress. It was not the first time someone had introduced a reform plan. Ever since the foundation of the People's Republic of China in 1949, the Chinese Communist Party had regularly introduced economic reform

plans. As the years passed by, also Deng's plans changed frequently and seemingly tended to be altered on an ad hoc basis without any underlying economic theoretical coherence. Nevertheless, in the time span of 17 years with a constant annual national gross output of around 10% and a steep rise in the welfare of the people, the economic system was radically altered, approaching a market economy. This leads us to propose the research question of how the Chinese government had been able to produce this success? What was the logic behind the Chinese economic reforms?

Preliminary research seemed to indicate that the Chinese leadership used the same logic behind most reform measures that it had taken during 1978 - 1995. However, what also surfaced was that there seemed to have been unintended interlinkage effects between the reform measures which affected the coherence of the used logic. The reluctance of scholars to analyse this latter issue and undertake an integrated approach to the entire economic reform process¹, in combination with the potential importance of such a research's findings encouraged us to pursue the proposed research question for the full reform process from 1978 to June 1995. Although I realised that an MLitt thesis could not present an extensive analysis regarding this complex topic, I believed that it would provide valuable new insights on the Chinese reform process and a new direction for future research on economic reform.

In search for the appropriate research methodology, the thesis followed the footsteps of Bates, Kreuger and some other distinguished academics², who came up with very strong analyses on economic reform in developing countries and China on the basis of a combination of political science and economic theory (public choice and institutional

economics). Chapter one compares other economic and political theories with this new research approach. Acknowledging its limitations the thesis argues that as a theoretical framework, the concept of rationality gives a clearer understanding of the Chinese reform process, and that it enables one to assess a variety of sectors and interest groups from a coherent position. Because this research stream has only started to develop over the past three years, I was compelled to develop a new framework. To this purpose the thesis uses (to my knowledge) the only general theoretical public choice research model that has been published on economic reform in autocratic developing countries so far (Frey and Eichenberger (1992)) and the results of an extensive politico-economic research project by Bates and Kreuger (1993) on 8 developing countries.

Although many of the underlying ideas of the developed framework and consequently my findings on China are similar to those of e.g. Gordon White, Susan Shirk and Jean Oi, my research methodology and approach are quite different. Firstly, in order to provide more clarity and oversight I constrained my extent of detail by basing my research on a set general framework. Secondly, the basis of this framework is both on political science as well as on economic theory. Thirdly, to reach a conclusion on the economic reform process, I analysed not only the state owned sector but *all* economic sectors, enabling me to establish the interlinkages between those sectors. Its limitations lie with the fact

The basic assumption of the framework is that all individuals, including bureaucrats and autocrats are taken to maximise their own power and money subject to constraints. Assumed is that authoritarian regimes try to reform the country in order to remain in power and maximise their own consumption. To establish the rationality behind the successive actions of the government, the first part of the framework creates the political and economic

situation the government is faced with. Central is the balance of power: the interrelationship and bargaining processes between the authoritarian regime and the most important interest groups in society (military, bureaucracy, management of large industry, rural and urban population). Secondly, it focuses on the different constraints the government will have to consider that influence its ability to reform. The bargaining and reform possibilities of the authoritarian regime are restricted by the political constraint (e.g. constant threats to its power), the technical constraint (e.g. state of the economy, limited governmental instruments to reform, dependency on functioning of the bureaucracy), and the resource constraint (e.g. limited financial resources and taxation possibilities). Further, it assumes that the government will act during the reform process so as to preserve its own power. Whether a measure will or will not be implemented is mainly determined by its economic cost (financial effect on the state budget) and political cost (effect on the power position of the government). In other words, the framework hypothesises that a government will balance the political viability with the economic rationality of each reform measure. The framework becomes dynamic in its findings when applied to subsequent reform periods. In this way it allows the analysis of interlinkage effects of the reform measures on both the government and other interest groups as well as on the constraints. The main focus of the framework are three reform measures that are prominent in most reform programs: balance the budget (abolishment of subsidies, deregulation of bureaucracy, defence budget cuts), restructuring of state owned industries, and devaluation of the national currency.

In Chapter 2 through 6, the thesis applies this framework to the Chinese reform process from 1978 to the first half of 1995. Chapter 2 addresses what the manoeuvre space was that the Chinese government had in its reform possibilities and whether the framework's

proposed reform measures ~~also~~ had any relevance in the Chinese case. It characterises the different constraints and the balance of power the leadership was faced with at the start of the reform process in 1978. Important political points are the structure of the Communist Party rule and its decision making process which was based on consensus. Also of importance was the influence the state owned industries had on the leadership via its budget dependency on their profits and the over-representation of the industry on the ministerial levels. Then the chapter addresses the economic and technical constraint mainly by explaining the working and limitations of the command economy, as well describing the bad shape of the state owned industries and the agricultural communes. The balance of power focuses on the political leverage the different interest groups had over the leadership.

Having established the Chinese playing field, the thesis focuses in the subsequent chapters 3-6 on the main reforms that were implemented or proposed during the reform stages of '78-'84, '85-'88, '89-'92, '92-'95, and the results they had for the state owned industry, the collective and the agricultural sector. Each chapter evaluates for a subsequent time period the political and economic costs the reform measures had on the power position of the government and its ability to reform (including the interlinkage effects the measures had on one another and on the participating interest groups). The framework identifies a continuous strain between the economic rationality and the political viability of many reform measures. In the period 1992 - 1995 (chapter six) this strain comes to a head when the deteriorated financial and political situation of the leadership leads to a strong loss of control over the actions of the provincial authorities. The regionalisation issue that had developed during the previous reform periods became a forceful event in the balance of power between

the provinces and the leadership, and consequently had a large influence on the ability for the leadership to keep its power position and continue its reform.

Chapter 7 summarises the findings of the case study and theoretical framework. Firstly, a conclusion is reached on whether the use of the framework has brought us nearer to the question what the logic of economic reform in China has been. Secondly, it is assessed whether the hypothesis on economic rationality and political viability holds for China. And where China and its leadership stand at the end of Deng Xiaoping's reform era?

Due to the vastness of the research area and secondly, the impossibility of direct contact with the Chinese leadership, the thesis is based on the extensive use of official Chinese economic data and other scholars' work. The importance of economic data to strengthen the inferences have led to the compilation of a large appendix with comprehensive tables and graphs. They are compiled from two primary resources, the China Statistical Yearbook 1992 (English) and the Statistical Survey of China 1994 (Chinese), and the BBC World Broadcast Service Far Eastern issues (1995). Furthermore, for the period 1992-June 1995, extensive use has been made of other primary resources in the form of the China Daily, Far Eastern Economic Review and again the BBC World Broadcast Service Far Eastern issues. It is specially the use of the western budget accounting principles in which the sale of government bonds and treasury bills, the reception of foreign loans, and the enterprise loss subsidies are *not* taken as revenue items on the government budget, that has provided much new information (Table 5, Graph 5)³. With exactly the same economic figures that the

³ Contrary to Western accounting principles, China includes the sale of bonds, treasury bills and foreign loans into their budget revenues. Therefore, the Chinese official budget deficit actually becomes much *smaller* and thus only shows the *unfinanced part* of the deficit. According to Western accounting principles the budget deficit that occurs as a result of real expenditure and revenues will not include any governmental borrowing that is used to finance this deficit. Instead this item occurs on a different separate account 'National Debt', which includes present and past borrowing (Klooster, 1989, p.74). To my knowledge all Chinese and Western academics use the

Chinese government uses, this thesis comes up with extensively different economic data inferences than the data that are normally used by scholars in the West and East. Especially after 1985, this accountancy difference leads to new insights.

Chinese official budget data, but never mention this important accounting difference. Only the Far Eastern Economic Review recalculates the Chinese budget to Western standards.

1 POLITICS OF ECONOMICS

1.1 Introduction

Many South East Asian autocratic states have been able to successfully implement economic reform plans. The prime examples are Taiwan, Hong Kong, Singapore and South Korea. That the government has played the leading role in the reform process is beyond doubt; they are autocratic nations. What scholars still need to agree on is the question of how their governments have been able to instigate these reform processes, and what the conditions for success were. Conversely, no agreement to date has been reached on what caused the failure of reform processes in most African autocracies as Sudan, Nigeria and Algiers? The framework that will be developed in this chapter is intended to provide an new politico-economic tool for analytical comparison of economic reform in autocratic countries. It remains clear, however, that a true test of validity and applicability of the framework needs more than the one case study that this thesis contains. But it is the importance of the research question and the possible answers that it might give, which provides the framework with its value.

This chapter firstly explains the grounds upon which the methodological choice is based by comparing economic theory and political science, as well as their cross discipline Public Choice theory. On this basis the analytical framework for authoritarian regimes develops in

the remainder of the chapter. To address the question why an authoritarian regime would even start an economic reform process, I have to begin with an analysis of how the political elite and/or dictator came to power, and how they try to remain in power. A picture emerges of the government being an endemic part of the economic process in a country. There is a strong economic and political interdependence between all the interest groups and the government. The framework that is developed sets a stage for penetrating behind these relationships. It tries to see the causal processes that generate them.

Having developed the foundation of my analytical framework the thesis then moves on to its second part: the actual reform process. It will establish that the survival drive of the government affects the contents of its reform plan and how it is implemented. The assumptions will lead to the thesis' hypothesis on economic reform concerning the political viability and economic rationality of each individual economic reform measure.

1.2 *Choice of methodology*

In 1978, when Deng Xiaoping introduced his first economic reform measures, the conditions were far from favourable for success. The political situation was unstable. The death of Mao in 1976 had unleashed a fierce power struggle within the top ranks of the Communist Party between Hua Guofeng (Mao's pre-eminent successor) and Deng Xiaoping. Two years later this struggle had still not entirely subdued. The political instability was complemented by economic instability. Welfare had been stagnating for nearly a decade

because of irrational economic policy making especially during the Cultural Revolution (1966 - 1976). There was a decline in the profitability of the state owned enterprises, agricultural output growth per head was declining, import of food was rising, energy and resource waste was mounting, universities were nearly all closed. One may assume that the chaos on the political and economic fronts in China was as all encompassing as in many other reforming countries today. Taking the unstable situation into account, the success of the Chinese government in not only starting but also continuing economic reform with positive results, becomes all the more interesting.

In my search for the appropriate research methodology I not only have to consider the economic system, but also the political system that - in the case of China - dominates the economy. A basic characteristic of the Chinese regime is its autocratic nature. The political leaders are in a dominant position and do not permit an institutional role for the citizen. The only way the citizen can influence the government is by uprisings, strikes or demonstrations. On the other hand, the government can resort to all kinds of force to repress the population or more specifically the opposition groups. This latter aspect took a gruesome form during the period 1956 - 1976 when the central government outlawed intellectuals, traders and industrialists. Hundreds of thousands people were killed or imprisoned.

A basic feature of the autocratic government is that it is an endogenous element of the politico-economic relationship; its survival depends on the support (or absence of opposition) provided by other groups in the society. The theory which takes as its main focus public policy making and analyses the role of the government and interest groups in the process of decision making is Public Choice theory. This theory builds upon the rational choice theory and assumes that all individuals, including bureaucrats and autocrats, are taken to maximise

their own power⁴ and money subject to constraints. While the vast majority of the Public Choice⁵ research is directed at Western democracies, Frey & Eichenberger (1992) have to my knowledge been the first to develop a model of autocracies on the basis of Public Choice theory.

One of the fundamentals of this theory is the existence of interest groups and their influence on the political decision making process. The most frequent used definition of interest groups (in the western political systems), as Mueller puts it, refers to a group of people that either “seek to further the objective of their members as factors of production or producers.... Others seek to influence public policy or public opinion respect to particular public good externality issues. In every case the driving force behind the formation of an interest group is the belief that its members have common interests and goals..” (Mueller, 1989, p. 308). If one wants to use the notion of interest groups in autocratic societies, this definition needs to be changed as the freedom to organise and to express one’s opinion are virtually absent. Ferdinand (1984), builds in his article on the validity of the use of interest groups in Chinese politics⁶ a strong definition which I propose to use in my framework. He proposes to define the interest group as: “....a collection of people who jointly make claims through or upon institutions of government, and the nature of the claim can be understood ... as a conscious desire to have public policy, or the authoritative allocation of values, move or continue to move in a particular general or specific direction.” In order to belong to this

⁴ Used definition of *power*: “...the ability of a person or group of persons to bring about the desired consequences even (but not necessarily) against the resistance of others. There is a multitude of forms which power can take with brute force and coercion on the one end, and then stretching to ‘milder’ forms like control, authority, influence and persuasion at the other end. The different forms can have different bases: force, constitutions, authoritarian status and hierarchy, wealth, knowledge, charisma and so on” Rothschild, 1993, p. 147.

⁵ Authors of Public Choice Theory are e.g. Breton, Cullis, Niskanen, Meuler, Rowley, Tollison and Tullock.

⁶ For a profound discussion on the use of the interest group concept for China, see: Goodman (ed.), 1984, *Groups and politics in the People’s Republic of China*.

collection or group, one does not need to be aware of this. As long as one shares certain characteristics (e.g. age, birth place, job), one can be said to be a member of a group without being aware of it, and even when one is aware, it certainly does not need to be the case that they interact together sufficiently to form a conscious group. One could distinguish "groups which perform socially significant roles and which therefore entitle an observer to infer similar view" (p. 15-23). Using this definition, I adhere to Frey & Eichenberger's assumptions on the formation of the most important interest groups in autocratic societies being the leadership, the military, the bureaucracy, the management of state enterprises, the urban population and the rural population.

Within their model, politicians in government may hold an ideology, but it is assumed that their most important and influential concern is mainly with consuming and maintaining power. I see ideology as an institution and consequently a constraint to the government. Furthermore, the rationality assumption implies that the politicians can perceive what constitutes their own interest. "They have an incentive to inform themselves sufficiently so that they can meaningfully evaluate the marginal benefits and costs of alternative actions. The politicians in power apply the instruments available to them "optimally". They compare the marginal net benefits of raising their own consumption *versus* increasing the chances of staying in power; to increase support by improving general economic conditions *versus* sanctioning the population, or to increase support by increasing bribes (positive sanctions) *versus* suppression (negative sanctions)" (Frey & Eichenberger, 1992, p.68).

On this basis Frey & Eichenberger (1992, p.19) establish three constraints an autocratic government is facing when it is setting up a reform plan.

In summary:

1. **Political constraint:** While in established liberal democracies politicians are subject to reelection constraints, politicians in developing countries are aware that they could be overthrown by a coup d'etat, an uprising or a revolution.
2. **Technical constraint:** The government is limited by the general economic and social conditions, as well as by the instruments available to pursue its goals. Its possibility set might be further limited by an inadequate bureaucratic structure.
3. **Resource constraint:** The government has limited means at its disposal for pursuing its goals. The possibilities of taxation are often severely limited (see also Theobald, 1990, p.83), and the government has to resort to other means of financing its expenditure.

When the behaviour of governments and how it deals with the political and economic cost of reform is the research focus, institutional economics provides another important variable that I will allow for. The theory of institutional economics points out that the behaviour of actors, including the government, is explained by the differing institutional conditions they face. Such institutions may include the judicial system, religion, markets, firms and price systems (Hodgson, 1993, p.i). I also would like to add ideology to this list. The different institutions determine the constraints and hence the relative cost (prices) of alternative courses of behaviour. Actors systematically respond to these changes in relative prices by choosing those opportunities with the highest net benefits. It is crucial to know the underlying institutions influencing the government's actions (Frey & Eichenberger, 1992, p.21).

In the short run, institutions can be seen as social regularities which gives the actor's behaviour a certain extent of predictability. "Institutions establish and reproduce a set of rules and behavioural norms. These are fixed in part by habit, but also typically by tacit or legally supported social acceptance or conformity" (Hodgson, 1993, p.xvi). This means that the possibility of influencing an actor's behaviour within given institutions is very limited. A government that has to act under institutional conditions where its survival depends on the absence of an uprising by the urban population, will not voluntarily implement a reform policy that will lower the standard of living of the urbanites.

Used on its own for this research, institutional economics would have the drawback that it is not flexible enough in a situation of dynamic institutional changes and reforms. Institutionalists locate individuals more deeply in a social and historical context, and see them acting according to the institutions they live by (Hargreaves, 1993, p.217). Within a reform period it is often hard to receive any reliable information on institutional change. During reform institutions change frequently. Often it is hard to establish what they are being transformed into as this process can take years. Public Choice on the other hand does not sufficiently take into account the influence institutions have on the individual preferences and constraints.

The main stream economic theories focus purely on the economic factors and disregard the interaction between the results of the economy's performance and the impact it has on the government's position. Economists tend to analyse the reform programmes and their outcomes on how they affect economic structure and growth (Bates & Kreuger, 1993, p.1). Vice versa, economists neither take into account how the government affects the economic reform process when its survival expectations change. The mainstream economic theories

deal with the market and address the government only insofar as to what it *should* do. They do not consider the motivations or behaviour of politicians and bureaucrats. It is assumed that these actors have no influence on their choice of policies or way of carrying out them. The government is an exogenous variable in the traditional economists way of research (Knudsen, 1993, p.267). In other words, the output of government is important, but *how* the decision making and implementation process works are not. Economic policy making then becomes a purely technical exercise (Levacic and Rebmann, 1990, p.439).

The political focus in the framework stems on the one hand from the used Public Choice literature (see page 199 in bibliography), and on the other hand from Soviet/ East European and China research, as well as a politico-economic research project from Bates and Krueger (1993) on economic reform in eight developing countries. In this last work Krueger and Bates invited for each country a political scientist and an economist to perform a case study. All economists received the same guiding questionnaires on the economic side, and the political scientists on the political side⁷. Unfortunately, the drawback of political science is that in general the behavioural assumption of self-interest is complemented by other variables such as altruism, morals, ethics and religion. This, however, would make the proposed research very complicated. The use of a plethora of behavioural assumptions would

⁷ "The political scientists considered the sources of opposition to reforms and the political difficulties that economic policy reforms created... They focused much of their analysis on identification of the political prerequisites for successful reform efforts." (Bates & Kreuger, 1993, p.1). The economists looked purely at the economic side of the reform process. The importance of this research project, in my opinion, not only stemmed from the strong analyses and conclusions that were reached, but also from the fact that this research showed the weaknesses of the individual approaches by the strength of the combined politico-economic conclusions. "... It is very often political factors which inhibit or prevent authorities from adopting programs which, on economic grounds, appear to offer the soundest prospect for resumption of growth and increasing living standards." (Bates & Kreuger, 1993, p.2).

necessitate the indicative approach of comparing case studies and makes it difficult to create a general framework which is applicable to more countries.

Finally, Frey & Eichenberger introduce in their model (1992) another interesting explanatory variable which I would like to include in my framework. *Attributability* is the concept of translating "... how an "objective" reality (such as income received) is evaluated and accounted for by the various actors. A rise in one's income may, for example, be attributed solely to one's capabilities, or it may be perceived as a payment from the government (or some other actor) in return for political support" (1992, p.21). "Wanting to survive, every government, of course, has an interest in making clear to the recipients (of income flows) that they risk losing it if they were to reduce their political support for the government" (1992, p.33). In the context of China, this addresses the question to what extent the various interest groups attribute the change in their economic and political situation (positive or negative): to the central government, to their provincial authorities, or to their local leaders.

1.3 The way to government

An autocratic government is a government that plays a dominant position in the economy and polity. The political leaders in government do not allow an institutional role for the citizen. The only way the citizen can influence the government is by uprisings, strikes or demonstrations. The government on the other hand, can resort to all kinds of force to repress the population or particular opposition groups. Even if most of the power is held by only one

of the political leaders in government - the dictator -, one can still assume that this person has a small group of confidants around him. This group of confidants will have much more power than the people underneath them in the party or bureaucratic hierarchy. Therefore one can identify the small ruling group or political elite, including the dictator, as the authoritarian regime or leadership. Another common feature of each of these elites is that they embody the ruling powers of legislation and the executive (albeit to different degrees) and will be the actor that sets up and implements the reform plan. I shall not make any specific reference in the rest of the framework to the degree of authoritarianism. The identification of this degree will automatically take place when a case study regime is applied in the framework.

In all forms of autocracy the main actor in the decision making process is the authoritarian government. It formulates public policy including any economic reform measures, and can do so without consulting its people. To understand the behaviour of the authoritarian regime, I first need to look at who this political elite are. How did they come to power? How are they trying to stay in power? This leads us to answering the question concerning, why an authoritarian government would start an economic reform process in the first place.

Generally speaking, one can differentiate between an authoritarian regime coming to power in a relatively stable political environment, and an authoritarian regime coming to power in an unstable political environment. The first situation arises when one authoritarian regime succeeds another authoritarian regime. The second situation happens more frequently and arises when an authoritarian regime has reached power by overthrowing its predecessor, or after a fierce power struggle within the top ranks of the bureaucracy. Therefore, in the development of the framework, the thesis will build upon the second situation. Also Bates

and Kreuger (1993, p.456) argue that most reform processes in developing countries have been started after a coup d'etat or major change in government had taken place.

Given the Public Choice assumption concerning utility maximising behaviour of all actors, the main objective of every authoritarian regime is the same as that of its democratic counterpart: after coming to power, staying in power. This enables the politicians to maximise their utility, of which wealth and power are the two most important variables (Wallis, 1989, p.23; Theobald, 1990, p.77/81).⁸ The longer they stay in power, the more (self-claimed) legitimacy they will achieve. It then becomes more likely that they are to remain in their position for a longer period. An authoritarian regime can claim legitimacy of rule mainly from three facts: first, from the period it has already held office; second, from being regarded as a 'good' person by the majority of the countries' population (e.g. Mao, ayatholla Khomeiny); third, by giving the impression of being strong enough to remain in office.

Thus, when an authoritarian regime reaches power by staging a coup, it initially needs to consolidate its position and bring the country to a stable political situation. Its first aim in office will be to limit threats to its power. Firstly, the group of people that helped the politicians to power, usually the military and some bureaucrats, will have to be awarded with positions that benefit them economically. This is important as they also have the power to oust their leadership. The handing out of jobs works both ways; their new positions make them economically dependent on the authoritarian regime's success in staying in power and the authoritarian regime's success is dependent on their co-operation. Consequently, they prosper with political stability and will help to accomplish this.

⁸ As mentioned earlier, because power and money are the most influential variables, and the importance of providing a comparative framework, I simplify the utility function to these two variables and pursue solemnly with the rationality assumption.

If the authoritarian regime exists in a society where the majority of the people who could affect its future are firmly convinced of the truth of some political or religious proposition, the politicians are likely to take up this proposition as this is a clear way to power. Coming to power through this scenario would mean that they should not only direct the group helping them to power positions in their new regime that will benefit them economically, but they will also be obliged to continue the proclamation of their mutual beliefs, ideology or religion. However, convictions are not always deeply held. Some politicians can change their ideology rapidly if there is a political gain to be obtained from it (e.g. the majority of the former communists in the Eastern European and former Soviet countries abjured their former ideology)⁹.

Secondly, the authoritarian government needs to avert two other potential sources of danger at the beginning of its reign (as well as throughout). The dangers are to be overthrown by a foreign intervention or a popular uprising. Military foreign intervention generally becomes a threat when the economic and strategic interests of a foreign country or countries are severely damaged by the actions of the authoritarian regime. These foreign countries will then search for reasons to justify the military intervention (e.g. Somalia, Kuwait, Haiti). The most recent interventions were all based on humanitarian grounds. Therefore, nowadays the best way of diverting the threat of foreign intervention is for the authoritarian regime to abstain from severely oppressing its own people.

Politico-economical foreign intervention occurs when the authoritarian regime applies for financial assistance to the IMF, the World Bank or other developing and Western bilateral

⁹ To quote the Protestant king Henry IV, House of Bourbon, (1553-1610) when he negotiated the terms of his succession to the French throne " Paris vaut bien une messe" (Paris is worth a mass). After this statement he promptly converted himself to Catholicism.

aid-agencies. From the early eighties onwards, most loans and financial assistance have been made conditional. These conditions are based upon free market principles and some international aid-agencies also attach direct political conditions. Implementation thus necessitates a loss of complete control over economic policy and therefore a decline in the absolute power of the authoritarian regime.

Due to a lack of any opportunities on political participation, the population is left with only one way of expressing dissatisfaction: a popular uprising (i.e. strikes and demonstrations). Such a popular uprising often occurs when the people are driven beyond endurance by oppression and/or hunger. To maintain the political stability the authoritarian regime therefore has to abstain from severe oppression, and provide at least enough food to keep people at the subsistence level.

After assuring its power position, an authoritarian regime will start justifying its action towards the people (including the military and bureaucracy). Not having been in the office before, the only claim to legitimacy left to the politicians is to show the people that they are 'better' people than their predecessor. They have to instil into them that they have affluent powers to stay and remain in their position. Generally, authoritarian regimes tend to go about this problem by accusing, or attacking their predecessor's policies and reign as 'going against the welfare of the common people'. They will proclaim that they will behave differently, and pursue policies that will heighten the country's welfare. The proof of their good intentions will be the introduction of an economic reform plan aimed at achieving this objective.

1.4 The balance of power

As mentioned earlier, Bates and Kreuger (1993, p.456) concluded that most reform processes in developing countries have been started after a coup d'etat or a major change in government had taken place and that the (crisis) state of the economy had always played a vital role. It is assumed therefore that the drive of the authoritarian regime to stay in power compels it to produce a reform plan. It will proclaim that it is going to change and reform all the abuses and mistakes made by its predecessor, resolve the prevalent economic problems, and increase public welfare. Success will legitimise its taking power. The reform drive will also give direction to the contents of the reform plan it wants to put into action. Having bargained away the threats to its power, the actual measures that will be taken during the reform process will be a mirror image of the prevailing balance of power between the most influential interest groups in society. To be able to discuss the contents of the reform plan, I firstly identify which interest or power groups play a leading role in the reform process and have a major influence on the government, and secondly, try to structure the rest of the population that have no or very limited influence on government power into a few groups. Research found that in general the group division in developing countries tended to be along the lines of: the military, the bureaucracy, the management of (state) industry, the urban population and the rural population.

The **bureaucracy** can cause the authoritarian regime more damage, or benefit the authoritarian regime more than the common people. To run a country effectively a ruler needs an executive body (either a military or a civilian bureaucratic body). This puts the

bureaucracy in a very strong bargaining position. The authoritarian regime therefore has to direct its attention to rendering incentives for the bureaucracy to provide political support for their new plans. It will have to produce a framework by which the bureaucrats can increase their personal income on the condition of full co-operation with the reform process.

Thus, the power of the bureaucracy stems from the authoritarian regime's dependence on its continued co-operation and support, and the intransparency of its organisation. On a macro level, the bureaux (as distinguished from the bureaucrat) work in the same way as their democratic counterparts. They receive a contracted budget, there is an absence of profit and competition in public goods output, and the bureaucrat's salary is not related to performance criteria¹⁰. The bureaucratic environment is an important determinant for the bureau's performance. Obviously, it is quite distinctive from a private sector environment. The direct causes of the subsequent supervisory control problem of its funding agency (the politicians) on the bureau's budget can be summarised as follows:

1. The government demands certain levels of activity by the bureaux from which output levels must be inferred (e.g. the universities are asked to supply certain degrees of human capital. Because it is impossible to define these degrees in money, the universities propose instead a budget based on numbers of personnel, buildings, books, etc.)
2. The bureau is not supposed to make profits.
3. The true cost schedule is known only to the bureau's members. The funding agency who provides the budget knows only the value of the activity level produced by the bureau (social or economic benefit) and its final costs.

¹⁰ Within Public Choice the topic of bureaucratic behaviour and budget maximisation is well discussed. See Mueller, 1989, p.252; McLean, 1989, p.87; Tullock, 1993, p. 42.

4. There is an absence of competition in public goods output, making any efficiency comparison between different bureaus impossible for their supervisors, the politicians.
5. The bureau receives a contracted budget from the government for a given budgetary period. It cannot go bankrupt if it spends too much. But if it spends too little, and the budget is not entirely spent by the end of the term, their next appropriation will decline accordingly. A decline in budget is a decline in financial resources and, thus, of bargaining power (political and economical). A bureau will try to prevent this from happening.

As a result, it is virtually impossible to interpret via regular accounting principles the bureaus' proposed budgets and nor the operational methods on their cost-efficiency. The only other possibility to check the cost-efficiency is by indirect efficiency control performed by the politicians themselves. The problem with this control is that there are severe limits on its efficiency. First, only the top bureaucratic layers can be handled personally. The larger the country, the larger the bureaucracy and therefore the more layers the bureaucratic structure will need. A large bureaucracy therefore has more freedom of action in the bureaucratic process.

This production environment and structure are the cause of the inefficiency of bureaucratic production. The stage is set for utility optimising bureaucrats to pursue budget maximising behaviour for their bureau. The larger the budget of the bureau, the more space for manoeuvre its bureaucrats have: more money for trips, business dinners and lunches, etc., but also more money to take on more fellow bureaucrats. This latter possibility will enhance the importance and bargaining power of the bureau. The bureau has the incentive to maximise its budget to the constraint that the budget must be at least as great as the total cost

of providing the extra output. This sets an absolute limit to the output at the point where an extra unit of output provides the bureau with no extra income at all (McLean, 1987, p.87; Mueller, 1989, p.252). In other words, like in the democratic systems, the bureaucrat is a budget maximiser.

With bureaus forever on a search for increasing budget appropriations, one would expect a constant growth in bureaucratic size. However, there are several constraints on bureaucratic expansion:

- the authoritarian government can use coercion if the bureaucrats do not co-operate satisfactorily.
- There is only a certain amount of revenue the government is able to collect, and thus provide the bureaucrats with. There are limits to the tax rates citizens are willing to pay. When they are set too high, tax evasion and a growth of the black market will occur, lowering tax income.
- The use of the money printing press to produce the necessary money resources in the majority of cases directly leads to inflation. The danger of this road is that rising inflation will cause a public outcry and unrest.
- Neither can the regime build up its national debt indefinitely. It can only rise in the short term without too many distorting effects on the economy, and thus the submissiveness and apathy of the public.
- Not all bureaucrats in the bureau are only prone to wealth and power maximisation. When they operate under a strong ideology or religion that, for example, advocates the abstention of wealth and power maximisation, this will act as a constraint. The bureau as a whole might then operate in a more budget optimising manner.

However, if one continues with the economic rationality assumption that bureaucrats are wealth and power seekers, one can assume that, on the bureau level, production efficiency is not high. On this assumption, Tullock (1993, p.42) traces the inefficiency phenomenon down to one variable, the absence of a clear production objective. In contrast to a business organisation, any means of evaluating the efficient use of the bureau's budgetary allocations are absent. In business, the reason for existence is clear and simple: profit maximisation, which implies a striving for optimal efficiency. The absence of such a clear objective in the bureaucratic production becomes the main cause for inefficiency. Efficiency does not stem from the form of organisation, but from its objective. Bureaucratic efficiency will not improve if business methods are applied.

Continuing the analysis on a micro level, under the same behavioural assumption I touch more closely upon the individual role of the bureaucrat. With a fixed salary and promotion being based on seniority rather than performance, what is the individual bureaucrat's incentive to work efficiently? In the absence of laws and regulations for bureaucratic behaviour, networking takes over. By networking, a bureaucrat can create gain for himself or his bureau: either a better job, position or membership in a bureaucratic network, or resources for the networks and bureaus. The trade of the bureaucrat are the resources of his bureau. The most important ones are project assignments, information provision, buying and selling capacity, jobs and money. Networking then can be regarded as a capital instrument, a factor of production (Breton, 1982). It is this production factor that he will use efficiently, but initially to pursue his own needs. These may or may not coincide with the bureau's needs.

The cause of the efficiency problem at the micro level stems from nearly the same causes as the efficiency problem at the macro level. Each bureaucrat has the same control problems as his supervisor. Every bureaucratic layer has this difficulty right up to the highest management level of the politician. He does not have the quantitative control measures to oversee the economic and efficiency performance of the levels under him. Rationally, the levels above and below him can negotiate among themselves to decide on their co-operative behaviour towards him. The lower levels can make deals on the amount of money they will hand over to him (e.g. tax), or which regulations given to them they will actually carry out. In other words, corruption can easily slip into the system, without it being discovered. There are instruments for a supervisor to control his organisation; spies in the departments, random checking of fulfilment of daily duties, creating different information channels in the organisation, creation of personnel staff or assigning outside control by independent accounting agencies (Tullock, 1992, p.52). The problem remains that there are no incentives for any bureaucratic supervisor to perform these control measures effectively as he does not gain much from improved efficiency.

Although in principle they are part of the bureaucracy, and therefore also operate in the same way, the **military** can be singled out as a separate interest group because it possesses an additional power threat: the use of violence. It can threaten to take power by a direct military coup when its wishes are not considered by the top political leaders. It can also threaten not to intervene in a political coup or popular uprising (Wallis, 1989, p.30/31).

In the absence of a voting system or other means of public policy participation, as well as their dispersed settlement, the **rural population** is left with virtually no political power. Their only power lies in the possibility of influencing agricultural production. More

often than not, the farming population has been used as a 'cash cow' for the government. This overtaxing has impoverished the farming population in many countries, leaving them with even less political power. Although certain rural areas may be barely surviving, and hunger is present, this does not create as big a threat to political stability as when a similar thing happens in a city. In general, the rural population is not capable of organising themselves and travelling to the cities to complain or riot.

The **urban population**, on the other hand, is capable of creating social unrest by rioting and striking in the cities. The political power of the urban population stems from this threat. The government has to take care not to let them slip beneath the subsistence level. As a consequence, their taxation levels are generally much lower than that of the farmers, and their subsidy levels are higher.

The **management of the state industrial sector** draws its political power from financial dependency of the government on their revenues and their provision of a social safety net. The strength of the political power of the **management in the larger private industries** depends on their relative contribution to the gross domestic product (GDP), as well as their relative contribution of profits and taxes to the state. The larger these contributions are, the larger their political power. In general, the accountancy methods in the developing countries are not standardised, and it is often the case that a lot of 'creative accounting' managers are able to lower their tax liability to the state. For the same reason, the management can either appropriate some parts of the company resources for itself, or hand it out as bribes.

In addition, the management of industry is often connected to the government, bureaucracy or military either through family or job-exchange. With the larger private

industries, the links often result from the fact that the government may have provided the money to start the business, and continue it. The ever growing population in many developing countries has also implied a growing reliance of government on industry in order to provide the necessary additional income. The management of the larger industries are well placed in strong bargaining positions.

1.5 Content analysis of the economic reform plan

I have set up the first part of the framework on the assumption that all people, and therefore all authoritarian governments, act in a rational self interested manner. A government which has recently come to power is most likely to attempt to reform the country's economy to gain legitimacy. It will try to establish this in such a way that it remains in power (and maximises its own consumption). The first part of the framework enables one to analyse the environment or 'playing field' for reform this government faces when it sets itself up for economic reform. The playing field's key elements are the balance of power between the interest groups and the government, and the technical, the political and the resource constraint. The next part of the framework will proceed along the same methodological lines as used in the previous sections.

Economic reform means a redistribution process of the nation's and governmental resources. Interest groups react to the effect the economic reform measures have on their relative power and wealth positions. The government possesses limited resources and thus has to make distributional choices and balance the level of distribution of these resources

among various interest groups to muster their support against the level of their own consumption. Its disposition over political power resources is extensive, but being an autocratic leadership it can only make limited use of the redistribution of these resources. It will be very hard to redistribute power among the other interest groups. The groups with power will have so much of it that they will easily be able to withstand any redistributive efforts that would leave them worse off. On the other hand, the leadership does not have much scope to redistribute their own power resources. If they do distribute too much power away from themselves, they simply might lose power altogether to one of the other groups who are the main receivers.

The extent to which a government is able to raise financial resources with which it can create interest groups' support depends largely on two factors (Frey gives this concept the definition of *appropriability*). Firstly, it depends on the economic structure of a country, meaning the extent of control the government has over the economy in terms of the export/import trade, price mechanism, labour market, natural resources and efficiency of the tax system. It can be hypothesised that the tighter its control, the easier it is to appropriate such resources. Secondly, the ease of appropriation also depends on the political and legal structure. It becomes easier to appropriate resources, firstly, the less powerful the groups are from which the resources are taken, secondly, the less political opposition there is, and thirdly, the more developed the administrative bureaucratic institutions are.

After having decided upon what the government deems necessary for its own consumption, the basic decision for the reforming government becomes how the rest of the resources should be distributed. Not every interest group's support is equally valuable for the government. The need for support is related to the strength and importance of an interest

group to the government's power position. For example, generally the rural population is less important than the military and bureaucracy. Concerning the distribution, governments can choose between improving general economic conditions, muzzling groups by spending resources on suppression (via the police, military or secret service), or by bribing groups to support them. Suppression obviously should not be a possibility for governments in (new) democracies. In autocracies, however, this possibility is widely used.

While most developing countries have similar economic problems, three measures can be recognised that are the most common as well as the most sensitive measures (to be) taken: the need to balance the budget, devaluation, and price reforms. An important reason for this similarity in reform content stems from the fact that these measures are generally prescribed by the IMF and the World Bank. Because most developing countries, authoritarian ones included, are in need of financial assistance the majority of these regimes have to make an effort to base their economic reform plan on the IMF and World Bank adjustment programmes. In order to become eligible for the credit facilities of these financial institutions, the governments are either supposed to carry out these adjustment programmes as a whole or include certain of its reform measures.

Although economically most of these measures would be rational for the government to implement, they are not always politically viable. All these measures have an important influence on the structure of the playing field. Consequently, in some countries their implementation may prove to be too harmful for the government's power position. Generally, the measures influence the interest groups along the following lines:

1. A balanced budget:

- a. *Decline of state ownership and state subsidies:* Most autocratic states have either state industries only (communist countries) or state dominance in industry. The international institutions favour as little governmental interference in the market place as possible. Therefore the institutions advise governments that the vast majority of state firms should be privatised, thus releasing the government from the financial responsibilities over these industries (e.g. countries of the ex-Soviet Union, Mexico, Kenya, Nigeria). However, the privatisation scheme of the state enterprises means job and income insecurity for managers of the firms that are inefficient and loss-making. Economic efficiency theory dictates that bankrupt and obsolete production lines should be shut down. In the remaining enterprises, a change of management and management systems should be pursued. Unfortunately, in practice, most of the state industries, especially in former communist countries, *are* operating inefficiently and are making a loss. For the managers in these companies, the privatisation scheme means the presence of incentives to use their economic power to obstruct the free market reform measures concerning their sector and to safeguard their income prospects. For the employees, it also means job and income insecurity, and thus is a potential cause of social unrest. The denouncement of state ownership creates a diminishing incentive to invest efficiently in the state enterprises, not only for the state managers themselves, but also for the bureaucracy. Productive expansionary investments will suffer as well as the maintenance investments as soon as plans or intentions are publicised.
- b. *Decline of bureaucratic regulation:* In the authoritarian state, the bureaucracy not only implements all the social and economic policies of the authoritarian regime, but also

regulates and controls the economy in varying degrees. According to the reform advice of the international institutions, the government should deregulate most of the bureaucratic responsibilities and regulatory powers. Reform should include the fiscal system, a reduction in effective decision making powers of the bureaucracy over the use of resources (especially the financial resources), an adjustment of the responsibility structure and control over property rights, the financial system (centralising the financial control over the banks and establishing a commercial banking infrastructure), and price liberalisation. The result of all these reforms implies a decline in the bureaucracies' income generating capacities (or bribing potential) and thus decline in their income. For the bureaucrats the deregulation and restructuring of the bureaucratic system generates incentives to use their political power to obstruct the reform measures as far as they reduce their income prospects.

- c. *Large cuts in defence budget:* Most autocratic regimes use suppression and force to rule the country and use the threat of war to gain power on the international scene. The strain the military expenditure has put on a lot of developing countries' production should be lifted to give the civilian economy a chance to recover. Nor can these countries actually afford to continue the huge military expenditures, as in general they have to cut down drastically on government expenditures. However, this reform measure would entail military unemployment and a major shut down in the defence industry. These latter parties are thus given a very strong incentive to obstruct the reform measures that affect their own positions.

2. Devaluation:

Often developing countries overvalue their currency to make imported goods cheaper. The benefits of this overvaluation go to the urban population and management of industries that need the import. The costs are mostly borne by the agricultural and the export sectors. Governments have been able to pursue this discriminatory policy because the rural population is very dispersed and incapable of organising efficient protest. The financial institutions advocate, however, a more export-led growth policy. By and large, the government of the authoritarian state has the incentive to devalue too little or not at all, to avert any unrest inspired by the urban population and import industries.

3. Price reforms

Most authoritarian regimes have some sort of price subsidisation scheme that benefits only specific interest groups. These subsidies have a highly distortionary effect on the price mechanism. Important are the food price subsidies that are given in many authoritarian states to the urban population as opposed to the fixed sales market prices they pay the farmers (often below the real market price). In 1990, for example, the Chinese government used 9.4% of the budget expenditures for price subsidies, against 5.5% of the budget expenditures for supporting agricultural production (Table 5). In general, the abolition of the price distortions will have the effect of a price rise in the cities: a potential source of social unrest. The government will have the incentive to retain some level of price discrimination favouring the cities.

If I continue my argument, I have to reach the conclusion that several scenarios are conceivable with respect to the economic reform plan and its implementation. Firstly, the

government may present a plan which includes the above mentioned measures, but it is not inclined to implement those that will affect the power of certain interest groups too negatively (e.g. delays in privatisation of state owned enterprises, in budget cuts for military and in restructuring bureaucratic institutions, like the banking sector).

The second option is that the government may modify the negative influence of the economic reform measures by including other (income) incentives for particular interest groups (e.g. tax exemption and interest free credits for certain industries or material support for the military, like free housing). The influence of these modifications on the macroeconomics coherence of the reform plan is questionable.

Thirdly, if the regime is *not* under influence of the condition as laid down by the international financial institutions, chances are that it presents a vague reform plan with a proclaimed objective like national welfare maximisation. Thus, a strong macro-economic foundation will not be found in the presented plan. The vagueness of the public plan would mean that the regime has a *carte blanche* in changing the economy of its country (its internal plan might even be detailed).

The first stages of the economic reform process will be vital for the credibility of the government's reform efforts. Therefore, it has to include in its plan some economic incentive for the urban population and strong economic incentives for the most important power groups. It would be rational for the regime if it created, for the latter groups, a situation whereby non co-operation would cost them money and co-operation would gain them money. The regime is able to pursue such a discriminatory policy not only because of the vagueness of the plan, but also because of the extreme inequality in the distribution of wealth. It is relatively easy to bring about positive changes for the poorest. The absolute figures do not

need to be large for the percentile change to be extensive. The attention to the real (re)distribution of wealth is then distracted.

This vagueness has several other advantages and characterises the process: nobody can anticipate the measures which are going to be taken; nobody can complain that the reforms are not carried out as planned, the government can experiment with different measures. The danger of this approach is that over the years, it will become increasingly hard to satisfy the wealth demands of the most important interest groups (Theobald, 1990, p.81). Their expectations rise according to their annually increased welfare. If the rate of money appropriation of government income does not keep up with these demands, the authoritarian regime will find itself in difficulties. Therefore, it is important that the reform process produces economic growth. An authoritarian regime can only take from the weakest and poorest groups in society the little they have. Finally, this ends up to be nothing, and at that moment might cause its downfall by a popular uprising.

1.6 The reform process

In practise, the actual contents of a reform plan differ from country to country. What measures are actually carried out and when, differs as well. Often the plans change during the reform process. "Economic responses to policy reform also take time. The time dimension adds further complexity to analysis, as the delays in response can be affected both by political considerations and by the expectation of businessmen and others....During the period in

which reforms are being implemented and economic responses are developing, political forces supporting or opposing reform can also change." (Bates & Kreuger, 1992, p.8).

The short-term impact of an economic reform process is very important for the continuation of support for the government. Unfortunately, one remains unable to determine the precise impact of a reform plan on specific interests until some time after its implementation. An element of uncertainty thereby slips into the economic reform process. People do not know how the reforms will affect their interests. This uncertainty creates scope for political activists (e.g. opposition politicians, human rights groups, dissidents, and also western economic advisers) to influence the people with rhetoric and persuasion. They will try to influence people's beliefs as to where their economic interests lie. Especially when uncertainty over the real economic effects start to grow, this rhetorical tool can have important consequences for the political stability of the country.

If the short-run impact of the reform process has a negative impact on the average living standards, one may assume that the political support for that particular program will erode, as well as the credibility of and belief in the government's abilities to sustain it. Even when the longer term outlook is theoretically very positive for many interest groups, pressures may arise which demand a reversal of certain reform measures. The benefits lie in the future and are therefore uncertain. The costs, however, are certain and occur in the present. For example, business sees itself deprived of certain tax exemptions; is subject to new tax rates; loses or is obliged to buy licences; or is faced with strong fluctuating/inflationary prices. "If people are rational, discount the future, and are adverse to risks, then they may find the expected utility of their incomes under the status quo to be greater than that

to be derived from the higher but uncertain incomes possibly attainable under the reformed set of policies." (Bates & Kreuger, 1993, p.456).

Another aspect should be considered if I evaluate the short term reform results on the continuation of the process and on the survival probability of the government: the extent to which the government is held accountable for the economic results of the reform process (Frey & Eichenberger's concept of attributability (1992, p.32)).

This depends on three conditions:

1. The government in power is held to be less responsible for the economic crises if it is able to convince the groups that it has been caused by the *former* government.
2. The present government can attribute the cost of undertaking the reform programme to *foreign forces* which are being presented as exogenous. The more credible the foreign scapegoat is to the population or particular interest groups, the easier it becomes for the government to lower attributability. Examples are world price increases, wars, boycotts, absence of foreign investments, and even the international financial institutions.
3. The population and groups may distinguish between *general economic conditions*, which they largely attribute to the government and *their own economic conditions* for which the government is considered less responsible. This implies that when most of the population is negatively hit by the reform process, they may attribute this to the government. On the other hand, it may also mean that when things are going badly for particular groups, these people might take more blame themselves.

The legitimacy of the government will heighten if the results in the short term are positive for most of the interest groups, and their support will grow accordingly. Nevertheless, the

government has to remain aware of any changes that occur in the relationships between itself and the interest groups. A success in economic reform is not equivalent to successfully remaining in power. When most interest groups become richer, it may imply that their power grows accordingly. A situation may then arise that a concentration is formed of one or several of these groups in a region, which may cause this region to develop faster than others. If this situation develops, it can create a difference in wealth and, thus, power between neighbouring regions. While the reform process is running its course, some groups or regions can start demanding additional changes in their favour, or even oppose the government's reign, whether it is an authoritarian or democratic one. Should their support be irreplaceable the government has to react to their demands and perhaps change certain reform measures in order to survive.

1.7 Summary

The assumptions made in this chapter will have to be tested in the case study. The most significant assumptions on the autocratic government's motives and actions during a reform process are:

1. As a rational self interest maximising entity, the government will commence a reform process in order to stay in power.
2. Therefore, measures that are proposed will or will not be implemented, but both these actions reflect the leadership's objective.

3. The government tries to muster support from interest groups according to their influence on the ability of the government to stay in power. Generally, these interest groups will be the bureaucracy, the military, the management of industry, the urban and rural population.
4. The most advantageous action for a government to take will be to try to create a situation where non-co-operation will cost the most influential interest groups money and co-operation will gain them money.
5. Wealth expectations of the interest groups rise according to their annual growth in wealth. When the government revenues do not keep up with these demands, the government's bargaining position weakens.
6. The government's appropriability (its ability to raise additional financial resources) is very important. A government constantly needs to address this issue.
7. Support also depends on the extent to which the government is held accountable for the economic results (attributability).
8. The reform plan will be vague.
9. Due to a high degree of uncertainty, the short term impact of economic measures is far more important for the government's support level than their potential long term impact. Short term reform successes will also heighten the legitimacy of the government.
10. The reform process is a dynamic process. The results of implemented reform measures might cause changes in the interests and utility of certain interest groups. In turn, this might lead to a change in their support level and balance of power with the government.
11. Most important are the changes that occur within the technical, political and resource constraint as a result of the reform process. Point 10 and this occurrence force the

government to a constant re-assessment of its reform strategy and the content of the reform measures.

12. If the opposition of an important interest group to a reform measure after its implementation is too high, then it is probable that a government will modify the results of this measure for this interest group.

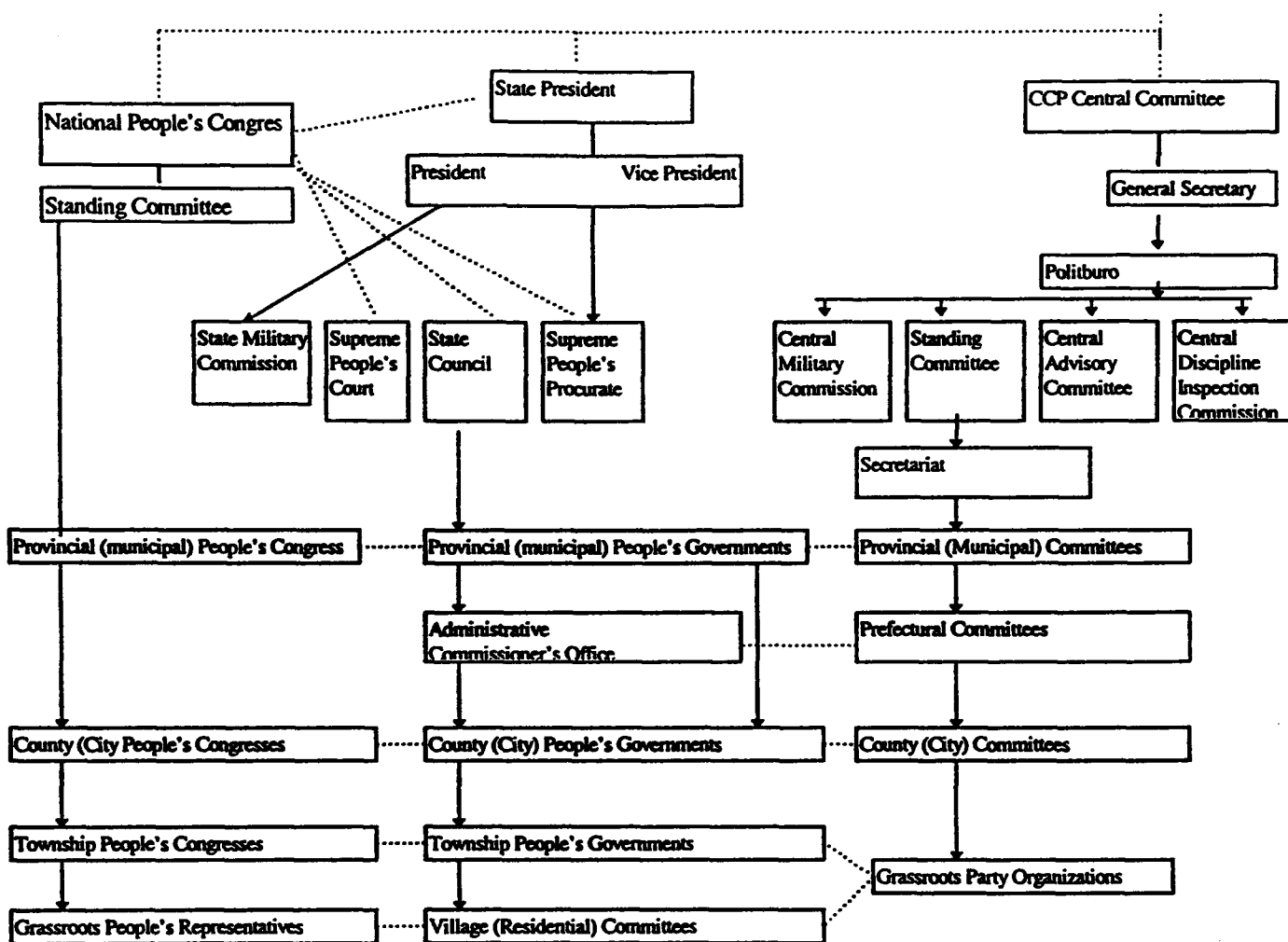
13. Success in reform is not automatically equivalent to successfully remaining in power.

In conclusion, I hypothesise that the government will act *during* the reform process so as to preserve its own power. Its actions, however, will be limited by certain constraints and the balance of power. The focus within the balance of power is on the interrelationship and bargaining processes between the authoritarian regime and the most important interest groups in society (military, bureaucracy, management of large industry, rural and urban population). The bargaining and reform possibilities of the authoritarian regime are furthermore restricted by the political constraint (constant threats to its power), the technical constraint (state of the economy, limited governmental instruments to reform; dependency on functioning of bureaucracy), and resource constraint (limited financial resources and taxation possibilities). By analysing all these aspects a 'playing field' becomes clear, the field in which the government can start acting.

During the reform process, the probability of the government's survival becomes the deciding factor. Consequently, whether a measure will be implemented or not, will mainly be determined by the economic rationality and political viability of a measure and its effect on the power position of the government. In other words, implementation and contents of a reform measure is based on a combination of economic cost, defined by the financial effects

the reform will have on the government budget, and of political cost, defined by the effect the reform will have on its political power position, that results in specific government reform actions (a positive cost is a gain).

Figure 1 - The power structure between the leadership, bureaucracy and Communist Party



—————> direct control
 - - - - -> linked

2. The start of an economic reform era in China (1978)

2.1 *Introduction*

To test the validity of the framework developed in the previous chapter, and whether it will enable the thesis to explain and better understand the workings of the Chinese economic reform process, I shall start with its application. The search remains focused on coming nearer to the answer of why the government in China was able to succeed, and what the logic behind the reforms was? This chapter will try to carve out the playing field for reform. After having identified who is in power and how they attained it, the technical, resource and political constraint will be expounded. Then the balance of power will be addressed, and the chapter concludes by considering the clarity of the developed playing field.

2.2 *Mao's political inheritance: the power struggle at the top*¹¹

The Chinese Communist Party had led China since 1949. In the course of the years, it had entwined itself in the society. The Party dominated the government and bureaucratic

¹¹ Liebertahl (1992, p.4) and White (1993, p.17) both emphasise the fact that foreign researchers have not been able to perform much empirical research on the bureaucratic process. Foreign access has been very limited, especially to the highest ranks of government. However, much has been written on this subject and a general consensus in the foreign literature can be observed. This and the following section are foremost drawn on the following literature: Blecher, 1986; Dreyer, 1993; Halpern, 1992; Hamrin, 1992; Lampton, 1992; Liebertahl, 1988; Saich, 1983; Shirk, 1993; White, 1993.

system, the military, as well as the social, cultural and economic life of its citizens. But 27 years of communist administration had not given the country a very promising future. The established economic system was inefficient and financially wasteful. The average standard of living was low and stagnating. The political system had brought numerous tumultuous campaigns that had victimised increasing amounts of civilians as well as Party members themselves. The need for realignment of the system was prominent.

Since its foundation, the Party was ruled in a hierarchic way by a small elite of around 25 to 35 top leaders (Liebertahl, 1988, p.36). Although the formation of this elite regularly changed, it was often the same people who were ousted and taken back again. This highest echelon of the Party consisted of the oldest Party members, most of whom had taken part in the famous Long March (1934-1935)¹², and also some protégés of the aforementioned group. In 1976, this elite still held the most important positions in government and the military¹³.

Although the political and economic situation was not promising, it was clear to the leadership that its power still remained within the realms of the communist system. Therefore, after the death of Party chairman Mao in September 1976, 'only' an internal power struggle erupted among the members of the leadership. On the main issue both of the two opposing factions agreed: the legitimacy and prestige of the Communist Party had to be restored and the way forward was economic reform (Shirk, 1993, p.23; Lin, 1989, p.117). What they did not agree upon was the direction these reforms should take and what their contents should be. A split in the leadership resulted.

¹² See Gray, 1990, p.270.

¹³ "The group is partly defined by the positions its members hold: most of the Politburo and secretariat of the Chinese Communist Party and of the standing Committee of the state Council, the commanders of the military, and the leaders of the wealthiest and largest cities." (Liebertahl, 1988, p.36).

The first faction¹⁴ was headed by Hua Guofeng and represented the more conservative line of the Party. After Mao's death and the downfall of his wife's 'Gang of Four'¹⁵, Hua Guofeng had taken over the most prominent position in the leadership, both within the Communist Party and the central government. His economic reform plans were based upon the old-style, only less extreme, Maoist traditions. Deng Xiaoping led the second more progressive faction. His power was based on the backing from progressive elements in the Party, a majority of the military and many high officials who had suffered during the Mao period. The economic reform plans proposed by Deng were a return to the plans of the fifties and did not consist of totally new radical elements (Kelliher, 1992,p.11). Economic efficiency was to be the focus of reform.

Between 1976 and 1980, Deng strengthened his position by rehabilitating many previously purged cadres - thereby earning their gratitude - and promoting his supporters in government and in the Party. At the same time, he tried to purge and marginalise his opponent's alliances (Dreyer, 1993, p.144). The downfall of Hua Guofeng was ushered in after the acceptance of Deng's reform proposals by the Third Plenum of the Central Committee in 1978.

Besides this internal power struggle, the threats to the power of the Communist Party and of its ultimate control over the economy were few. Firstly, the cold war between the US and the Soviet Union was at its height. Both countries needed a third large nation to strike the balance. At that time, a large scale foreign military invasion seemed very unlikely. Secondly, the absence of an external financial debt released the leadership from strictly adhering their

¹⁴ For more details about the internal power struggle between Deng Xiaoping and Hua Guofeng, see: Dreyer, 1993, p.143/144; biography on Deng Xiaoping by Bonavia, 1989, p.161/169; White, 1993, p.25/26.

¹⁵ See Gray, 1990, p. 380-382.

economic reform plans to any policy advice offered by international institutions. To quote Jacobson and Oksenberg (1990) who have performed the most extensive research on China's participation in the IMF, the World Bank and GATT : "Our extensive interviews suggest that the World Bank and IMF, while influential, have *not* been the source of the reform program which, after all, began before China's participation in the KIEOs [keystone international organisations]. Rather, there has been a convergence of views." Thirdly, despite the low standard of living in urban areas, its urban population did not live below the poverty line. In addition, the population had just been through a prolonged period of successive social upheaval: much eagerness to start yet another may assume to have been lacking.

2.4 Constraints on economic reform

The question for the leadership now was what reform direction it had to take. But what were the directions that were open to them? This section tries to infer the limiting factors that the leadership was confronted with during its internal negotiations on the contents and sequence of the reform measures.

The *political constraint* was primarily constituted by the existing power structure between the Communist Party and government. The vagueness of the barrier between Party and government was created by the Party to tighten control on the government bureaucracy (see Figure1). "The Party has formal authority over the government but delegates to the government much of the actual work of administering. The Party's authority over the government is based primarily on its authority to appoint and promote government officials

what in the Soviet Union is called the nomenklatura power....The Party also sets the general policy line for the government to implement, approves the government budget and plan, and oversees the work of the government...The control over the government is found in the parallel control. Almost all government officials and all top officials are themselves Party members; and in each government agency, party members are organised under a party committee that is subordinate to the Party committee at the higher administrative level. The hierarchy of government organs is overlaid by a parallel hierarchy of Party committees that enable the Party leaders to supervise Party members in the government and lead the work of the government” (Shirk, 1993, p.55). The Party therefore could remain relatively small and still keep control. In 1978, only around 7% of the adult population belonged to the Party (World Bank, 1982, p.47).

Secondly, the existing bureaucratic decision making process was a strong determinant of the political constraint. Within the Party and government bureaucracy a decision making process had developed itself that was based upon a consensus rule and not upon a majority rule. In 1978, the difficulty was the split in the leadership. The consensus rule provided politicians the opportunity to delay the taking of decisions for certain controversial reforms, particularly on industrial issues. The mere fact that the industrial sectors were over represented within the leadership - heavy industry had 14 ministries, light industry one and agriculture one- did not show much chance of quick changes in the state owned industrial sector.

Asymmetric information was another problem of the decision making process. The majority of officials spend their entire career within one sector or province. This created very strong vertical loyalty ties among the bureaucracy. When an official finally reached the

ministerial post, he represented an entire sector underneath him (Liebertahl, 1988, p.61). In the absence of any other lobby possibilities ministers acted on behalf of their sector and lobbied for their interests within the leadership. The political structure did not create much incentive for ministers and bureaucrats to confer much horizontally. In 1978, this was a particular problem for the leadership as it had to take policy decisions on reform measures that possibly could have horizontal influences on several economic sectors via inter-industry linkages.

Finally, the last element in the political constraint was formed by the existing ideology. Any reform measure had to remain within the realm of communism. Proposing a change in the communist ideology would be equal to changing the political system, something that the leadership wanted to avoid. Communist ideology provided the strongest source of legitimacy the leadership had at that moment.

The *technical constraint* was mainly composed by the straitjacket of the existing socialist economic system. Since 1949 the Communist Party had developed a Soviet type of command economy¹⁶. At face value, the Chinese communist system had been able to accomplish astonishing industrial growth figures¹⁷. Between 1957 and 1979, net industrial output increased at around 10% per annum in real terms. Per capita GNP appeared to have grown at an annual rate of 2 - 2.5% (World Bank, 1983, p.11). It also accomplished to enshrine in its development, a system that was able to provide basic health care and housing

¹⁶ More detailed information on the former communist planning system and the use of the material balance method see Ellman, M., 1989, *Socialist Planning*; Brus, W., 1973, *The economics and politics of socialism: collected essays*; Nove, A. (ed), 1972, *Socialist economics*.

¹⁷ The reliability of the Chinese economic data as provided by the Chinese Statistical Bureau is questionable. However, Martin Wolf reports in his FT article on Chinese statistics that the Chinese official data are far from perfect, but that neither any alternative estimation methods has provided solid data estimations (FT, 7 Nov. 94, Survey p. 4). In line with the majority of the academic research on China, this thesis therefore works with the official Chinese statistical data.

for almost all Chinese, and to provide a minimum guaranteed level of food supply. Income inequalities were largely eliminated, and employment was guaranteed for both men and women.

However, these positive accomplishments have to be put into the right context. There were also some less promising economic figures. The fact remained that the industrial work force was only 24% of the total labour force. Most people were still dependent on the agricultural sector for work and income, but the output growth of this sector had been outpaced by the population growth. Consequently, net output per agricultural worker had dropped 12 % between 1957 - 1977. Per capita income had therefore risen slowly (World Bank, 1982, p.12). A second influence on the stagnation of peasant welfare was the fact that the improvement in agricultural technology not only raised output, but also the costs of production, and with a higher margin. The income per hectare declined. Thirdly, even if farmers produced more, the state entitled itself to these higher proceeds.

Neither the industrial figures were all financially healthy. Gross output value per 100 yuan in industrial fixed assets had fallen by 25.4% (Shirk, 1993, p.27). In terms of economic efficiency all figures showed a decline (Table and Graph 10, 11, 12). For example, the losses as percentage of profits had been rising from 9.1% in 1972 to 24.2% in 1976 , and down again to 15.8% in 1977. Furthermore, the pre-tax profits as percentage of the original value of the state owned enterprise's fixed assets had declined from 30.2% to 22% in 1977 (see Table 10). Marginal capital output ratios were static or declining; output and pre-tax profits per unit of capital was declining (White, 1993, p.31). Other deficiencies in the state owned enterprise sector were the persistence of a soft budget constraint, excessive wage growth, resource waste, and the stock piling of resources. These deficiencies were not only common among the

Chinese industrial sectors, but a feature of all Soviet type economies and therefore reflected a structural error in the applicability of the planning system and implementation of the communist economic theory.

In terms of welfare, an estimated 31% of the population lived below the poverty line. Compared to the international recognised minimum food standards of 2185 calories, in 1977 the average daily calorie intake of the Chinese was around 2000 to 2100 calories, of which 80% to 90% came from grains (World Bank, 1985, p.30).

The idea behind a command economy was that the anarchy of the market was to be replaced by a state administered planning mechanism. Practically, this implied for both the industrial and agricultural sectors that the state allocated labour, capital and material input resources, fixed the output prices, and managed all intermediary services. The state abolished the free input/output and labour market, prohibited competition and any pursuit of profits. After the communist take-over in 1949, the industrial sector was rapidly nationalised. The agricultural sector saw its first extensive reforms after 1957 with the introduction of the commune system. All arable land was turned into communal property, to be cultivated by the farmers collectively.

Production in agriculture and industry was to be accomplished according to a plan drawn up by the state. This plan determined, first of all, the annual production quota local communes or factories had to produce, and secondly, it distributed the necessary input resources. The data in the plan were configured with the aid of the material balance method. This technique enables one to calculate (via aggregation of quantitative data) the necessary total production levels of intermediary and primary goods, in order to produce a certain

planned output level of finished goods. The required data to conduct the material balance method were collected by the local bureaucrats directly from the factories and communes.

These local bureaucrats would discuss and bargain with their colleagues of the same rank, over the necessary resources and production data that would be passed on to the next bureaucratic level. After the data would have passed upwards through all the bureaucratic levels (local, county and provincial), they would arrive at the Planning Ministry for final processing. This Ministry would produce the national plan that subsequently would be broken down again in smaller plans and sent down to the next bureaucratic level. Every five years this procedure would be repeated and data could be altered, upon which a new plan would be developed.

Since it was virtually impossible to calculate, via the material balance method, all industrial and agricultural production, the leadership was forced to select priority sectors. To these sectors they could devote more attention to make sure that it would receive the correct inputs and produce sufficient outputs. The main priority was placed on the development of the heavy industrial sector. Between 1949 and 1978, three times the amount of money was invested in capital construction for heavy industry as in agriculture and light industry (World Bank, 1982, p.11). This was done despite the fact that the vast majority of the Chinese earned their living in agriculture. A result of these high industrial investment figures was that the industrial share in the Gross Output Value of Society (industry and agriculture) went from 34% in 1952 to 60% in 1978.

On the micro level, the technical constraints in the state owned enterprises (SOEs) were important for the reform process. This sector provided 80% of the government's budget revenues, and received over 50%. In 1978, the majority of the total industrial output was

produced by two categories of state owned enterprises. The first category was comprised of the large state enterprises that were tightly controlled by the central government's planning and administrative apparatus. They were small in number, but accounted for large shares of industrial output, assets and profits. The second category was formed by the smaller state enterprises which fell under the local jurisdiction of county or municipal governments.

The function of the state owned enterprises went far beyond the production of goods. It took care of workers' housing, education, health care, food service, pensions and in many cases, local public services and infrastructure. As already mentioned above, the plan decided an enterprise's production and input level. Besides these quantitative measures, the Party also decided on matters as its operational methods, labour hours, and product mix.

The problems within the state enterprises stemmed for a large part from their organisational structure: the lack of management autonomy¹⁸. Each enterprise was actually ruled by a Party bureaucrat who had been appointed to the management board. Just as in the bureaucracy (see political constraint) this control structure was implemented by the Party to secure better and shorter communication lines, and in the case of the state owned enterprise, would enhance a uniform national enterprise development. In the state owned enterprises, the Party bureaucrat's powers were extensive. He could overrule management decisions, appoint managers as well as influence their career prospects. Important in the shortage economy were his contacts with other state owned enterprise's Party bureaucrats, whom he could call upon to help his enterprise in the bargaining process on quota planning, to gain bank credit, or to secure inputs.

¹⁸ For an in-depth analysis of the manager's and Party bureaucrat's role in the SOEs, see: Walder, 1989, "Factory and manager in the era of reform" in: *China Quarterly*, June 1989

In theory, these powers of the state owned enterprise Party bureaucrat over the enterprise management did not have to be negative for the performance of the enterprise. However, practice showed that the bureaucrat's institutional environment apparently did not provide him enough incentives to create a cost-efficient, profitable enterprise as by 1978 it was exactly these latter characteristics which were lacking in most state owned enterprises. As already mentioned, his career and income only depended on plan fulfilment.

The role of the managers was literally only that of managing the enterprise. The manager's environment on the financial and political side was characterised by the following:

1. The enterprise was always bailed out if it made losses, either by the local or central government.
2. As a result of the planning system, neither the input prices, nor the output prices reflected the real cost or profits of the enterprise.
3. The enterprises did not work with a standardised accountancy system.
4. All profits went to the central government; so would any rise in profits.
5. His personal income was not linked to profits, or cost-efficiency, but to plan fulfilment.
6. Like the party bureaucrat, his career was also based on plan-fulfilment,
7. as well as by his relationship with the enterprise Party bureaucrat, other bureaucrats and his employees.

In summary, the crux of the Chinese industrial system was on the one hand data inaccuracy, and on the other, the absence of cost-efficiency enhancing incentives at the enterprise level. The reward mechanism created an incentive to overestimate the real required resources and to underestimate the potential maximum production levels. Data were manipulated by all

bureaucratic layers. “Thus, the economic system as a whole tends to sink into a low level equilibrium of low productivity and low effort.. Production data are abundant but these merely reflect an institutional consensus about appropriate levels of effort rather than actual information about attainable levels of output.” (Naughton, 1992, p.247). These systemic difficulties imposed a strong constraint on the leadership to reform economic sectors within the existing economic system.

For the philosophy of the command economy to work in agriculture, the entire agricultural sector had been restructured into communes. “At the bottom of the commune system was the production team. A team contained one or two hundred people from the same village (or sometimes several small hamlets) who owned the land collectively and shared both the work and the output. Anywhere from two to two dozen teams comprised the next higher unit, the brigade, which ran most rural industry. At the top of the structure overseeing roughly ten to twenty brigades and answering to outside officials, was the commune itself. The commune performed administrative duties and saw the brigades and teams delivered their production quotes to the state” (Kelliher, 1992, p. 9). Individual mobility was strongly discouraged through local registration which gave singular access to local social security benefits, food, housing and health care.

The farmer was reduced to a small radar in a big mechanism and had no influence on his own welfare. With hindsight I can assume that similar to the state enterprise managers, the farmer’s institutional environment did not provide him the right incentives to develop cost-efficient or highly productive farms. In short, his environment on the political and financial side:

1. The commune was always bailed out if it made losses.

2. As a result of the planning system, neither the input prices, nor the output prices reflected the real cost or profits of the commune.
3. All proceeds went to the state; so would any rise in output.
4. The farmers' income was not linked to profits, or cost-efficiency, but to plan fulfilment.
5. Due to the restrictions on interregional trade and labour movements, farmers in a poor unit had little chance to find work elsewhere, to start a business or to sell extra output outside the state plan.
6. The individual farmer had no means of public policy participation.

The *resource constraint* was constituted by the fact that 87% of the government's budget was financed through taxes and profits of the state owned enterprise sector (Table 7) and that this sector had been showing a gradual but continuous decline in profitability (Table 9/12). Other resource possibilities were few, and certainly unattractive. Monetary expansion could fuel the suppressed inflation rates and create rising shortages. Consumption price rises could incite urban unrest. International debt seemed politically the safest option, but would induce western policy interference. A personal income tax system had never been introduced as this had always been regarded as a highly capitalist practice. Installing one was not even an option.

2.5 The balance of power between the Chinese interest groups

The last part of the framework's 'playing field' for reform is to analyse the balance of power between the different interest groups and the leadership around 1978. Although in all cases, the ultimate balance of power lay with the leadership, below this existed an extensive power hierarchy among all the other interest groups. One could identify the most influential interest groups to be the bureaucracy, the military, and the management of the state owned enterprises. The rest of the population could be broken down into two large interest groups: the urban and rural population.

The framework assumed that a bureaucrat is a self-interested individual, seeking wealth and power and concluded that the power of the **bureaucracy** primarily stems from the authoritarian regime's dependency on its continued co-operation and support, as well as the intransparency of its organisation. Bureaucrats engage in budget maximising behaviour. The larger the bureau, the more power it has. The absence of both a clear production function and bureaucratic control mechanisms results in a high inefficiency level. In China's case, this result was already observed in the political constraint. Furthermore, bureaucratic behaviour was exacerbated here by the fact that the majority of the officials spent their entire career within one sector or province. It created very strong vertical loyalty ties among the bureaucrats. Bureaucrats lobbied solely for their own sector. Consequently, the leadership had to muster support from each ministry and province on a more or less separate basis, causing it to need an even larger financial and political resource base. It remained a fact for the

leadership, however, that without the bureaucracy's co-operation there would not be much chance of successfully implementing any reform measures.

The **People's Liberation Army (PLA)**¹⁹ was another very powerful interest group. Despite the impressive numbers of people under arms (estimated at 4,234,210 armed forces and around 20 million armed militia (Woodward, 1985, p.173)), various authors found that the army had become inefficient, lacked discipline and professionalism, and operated with very old, inadequate equipment. Mao's fight against professionalism had not improved the military's position much. Perhaps not very surprisingly, it was the military who arrested the 'Gang of Four' after Mao's death, thereby opening the way for the new leadership, including Hua Guofeng and Deng Xiaoping, to seize power (Jenner, 1992, p.252). I assume that this, in its turn, opened the way for the military to negotiate their terms of 'trade'. Their power was based on the threat that they could bring down the ones they had helped to power. Additionally, the military also had a platform within the industrial ministries. All but one of the six of the machine building ministries produced military equipment and were administered by the PLA (Shirk, 1993, p.108).

The **urban population** in China was relatively small but their power had always been fairly large as they were in a position to assemble and riot. This would have not only meant the disturbance of city life, but also affect the state owned industries. As a result, the urban population had received under Mao preferential treatment with respect to social services, food subsidies, employment and housing. The high cost that went with this policy was one of the reasons which impelled Mao to a policy of restricting rural-urban migration. By 1978, according to official Chinese figures only 20.6% lived in the cities and towns. The real figure

¹⁹ Authors on the People's Liberation Army are Blecher, Joffe, Pollack, Segal and Woodward.

of people living in urban areas, including the towns that were not officially recognised, is not exactly known but seems to have been around 30%. According to Perkins, urban consumption per capita between 1950 and 1978 would have remained two and a half times those of the rural areas (1990, p.102). In 1978, the leadership was thus confronted with Mao's inheritance of a 'spoiled' urban population. It could be assumed that any readjustment of prices back to their market clearing level would be resisted. In addition, it was again the fact that the leaders were so dependent on the state owned enterprises for financial resources that this gave the urban population additional political leverage.

Because there was no private industry, the only industrial sector of influence was the state owned industry. As a result of the priority the Communist Party had put on heavy industry, it was this branch in particular that had political power. Their political power mainly resulted from three facts. Firstly, the state owned industry had a disproportionate representation within all layers of the Communist Party. In order to control the enterprises' production the Communist Party had put an additional control mechanism in place. Almost all managers and certainly all enterprise Party bureaucrats, had to be members of the Communist Party. This gave them their first platform to influence policy making. Secondly, their other platform was within the bureaucratic structure. Here they were also disproportionately represented. Over 90% of the ministries was for the heavy industrial sectors. Thirdly, by 1978, the leadership was largely dependent on their financial contributions to balance the state budget. Consequently, **the management of the state owned enterprises** had a very large influence on both the decision making process within the leadership, as well as the power to oppose decisions, or simply not to implement them.

The final interest group, to which most Chinese belonged, was the **rural population**. The political power of the rural population itself was virtually nil. As in other authoritarian states, there was no voting system or other means of political participation for them. According to Shirk (1994, p.13), "...the rural population is also underrepresented within the party membership and its leading organs and the government agencies that represent the interest of rural agriculture are weak." In addition, their dispersed settlement, the bureaucratic control on transport and the mere absence of private transportation meant also that they were denied the opportunity to assemble and voice their opinion in Beijing.

2.6 Summary

In reference to the framework, this chapter established that up to this point in the analysis China's picture fits into the framework. Firstly, around the beginning of its reform process, China was undoubtedly an autocracy. Secondly, the condition that the country should have just undergone a power change is also fulfilled. The Cultural Revolution had left China in a state of political and economic chaos. Within the Party, Deng Xiaoping and his faction ultimately took over power. Thirdly, most scholars seemed to agree on the fact that the leadership needed an economic reform process in order to gain legitimacy and consolidate their power. Fourthly, when applied the framework's playing field structurally addressed how the economy and political system worked. It also elucidated the power position of the interest groups vis-à-vis the leadership and what their political leverage over the leadership was. So

far, the framework's application has provided a clear analytical point of departure for the remaining case study.

Important findings were that in spite of the Chinese leadership's consensus on the need for reform, the leadership was divided on the direction that the reforms should take. The division split the leadership internally into two rivalling factions. Besides its internal rumblings, the leadership's main limitations to economic reform lay both in the economic as well as in the political spheres. In economics, the main determinants were the communist economic planning system and the dependency of the leadership on the state owned enterprises for their budget revenues. In politics, the constraint mainly stemmed from the power structure between the Communist Party and bureaucracy, the prevalent bureaucratic decision making process of consensus seeking and its problem of asymmetric information. Within the balance of power, it were especially the management of state owned enterprises, the military and the bureaucracy, who seemed to preside over considerable means to influence the leadership during the decision making process.

Table A - Estimation of reform measures' political and economic cost on the leadership's ability to stay in power

Start of the reform process 1978

Measure	Economic cost	Political cost
Food consumption price liberalisation	High gain - The lifting of price subsidies stops their increasing drain on the state budget.	High cost - Without industrial wage increases there is a high chance of potential urban unrest
Agricultural output price liberalisation	Medium cost - Drain on budget if a price rise is not passed on to the consumers. Medium gain - In conjunction with liberalisation of the food prices, profits could be made by the State. Positive influence on the budget.	Low gain - Rural population: their income will rise, but their voice does not carry much political weight. Low gain - Rural population: their income will rise, but their voice does not carry much political weight.
Primary resource price liberalisation	High gain - If a price rise can be passed on to the final consumers and consumption demand will not decline too much, profits of SOE primary industry will rise and so will the State budget. No gain - If a price rise can not be brought forward the profits of the recipient state owned enterprises will decline with the amount that the primary resource sector sees its profits grow. Consequently there will be no net profit gain for the state budget.	High cost - Without a real income rise to offset the consumption price rises there is a high chance of potential urban unrest. Low cost - The decline in SOE profitability takes away some of the freedom the management had in their wage policy, notably the bonuses. Political resistance may be expected.
Cuts in defence budget	High gain - The lowering of the defence cost would improve the state budget.	High cost - The military would not appreciate a decline in their budget. They have the threat of a military intervention.
Restructuring SOE	High gain - The state budget is largely dependent on the profits of the SOEs. If efficiency enhancing methods on accountancy, labour, operation, stock piling, resource use were introduced there would be a high chance on higher profits without even rising prices.	High cost - Technical, political and resource constraints defers basis for fundamental systemic reforms in planning system, it also creates a strong bargaining position for SOE; any reforms resulting in income losses or job insecurity for management and employees can be obstructed.
Bureaucratic deregulation (especially of economic control)	High gain - If implementation in conjunction with other macro economic control mechanisms like a new tax and financial system or property rights structure, the economy would gain more freedom and most likely would respond positively, resulting in higher state revenues.	High costs - The bureaucrats would lose large parts of their income generating capacity (or bribing potential). Co-operative behaviour most likely to be low, absent or even trying to reverse to measure.

3. Success of the agricultural reforms (1978 - 1984)

3.1 Introduction

Between 1978 - 1995, in the time span of 17 years, the Chinese economic system was radically altered. Although economic reform measures were often taken on an ad hoc basis and many were constantly changed, annual economic growth was 10 % or higher and the general living standard had improved significantly. How had the Chinese government been able to produce this success? What was the logic behind the economic reforms? The following chapters will try to analyse these questions, and see whether the framework's hypothesis that an autocratic government will try to combine political viability with economic rationality during its economic reform process holds for China? After having set up the Chinese playing field in Chapter 2, the focus will be on the various reform measures and both their direct and interlinkage effects on agriculture and industry. The thesis will also try to evaluate their effects on the playing field; the changes that took place in the constraints and balance of power. This chapter looks at the first period of reform 1978 - 1984. To limit the scope of the research the emphasis is placed on the most sensitive reform issues: state owned enterprise reform, price rationalisation, defence budget cuts and bureaucratic deregulation.

As already mentioned in the Introduction, an important factor in the following chapters will be the use of a Chinese government budget that has been set up with official Chinese data, but according to the Western budget accounting principles (Table 5, Graph 5).

While China includes the revenues from the sale of government bonds and treasury bills, the reception of foreign loans, and the enterprise loss subsidies as budget revenue items, the West does not. The 'changed' budget leads to entirely different inferences in this thesis.

3.2 Planning economic reform

Although I have analysed in the previous chapter what the most pressing economic issues in China were, the actual measures Deng Xiaoping proposed during the 11th Congress in 1978 only made a vague step towards solving these problems. The proposed measures were directed, firstly, at policy changes concerning industrial priority and patterns of resource allocation and, secondly, systemic changes in the economic management and planning apparatus at the macro and micro levels (Lin, 1988, p.9). The most important measures included:

1. Enterprise autonomy was to be the centre of reform. Decision making powers over production planning and resource allocation should be decentralised to both local governments and enterprises.
2. Experiments with material incentives were to be introduced in some enterprises through the introduction of profit retention and bonus systems.
3. Within the agricultural sector the measures comprised several policy changes: an increase in the state purchase price of agricultural produce to enhance production incentives, relaxation on mandatory grain production and stimulation of agricultural diversification

and an increase in the autonomy the production teams. More structural in nature was the opening of limited free markets.

4. The military would be modernised.

In 1978, the leadership, thus, did *not* propose to change the expensive urban preferential treatment; to stop subsidies and other preferential treatment of the state owned enterprises; to change its industrial investment policy; to abolish the commune system and its price controls, to make cuts in its defence budget or change its bureaucratic organisation. In theory, these would all be for the leadership economically rational actions as well as financially advantageous to undertake. I tried to deduce the potential economic costs and gains of these measures in Table A. If one looks at this table, one can see that all of these probably would have actually produced an economic or financial gain for the leadership. Following the framework, I therefore tried in the same table to infer whether there were political reasons for their absence. It turns out that the problems of these reform measures as identified in the framework also holds for China. When mapped out in the playing field, it seems to be that even if the leadership had wanted to implement more market oriented reforms, their political costs would have been far too high for the government to gamble on. Table A shows that although for some reforms the gains were financially high, they were accompanied by high political costs.

Besides agricultural price liberalisations, one of these measures, however, was proposed by Deng despite its high potential political costs: restructuring the state owned enterprise sector. The thesis deduces that the leadership had no other alternative than to

embark' on a reform mission concerning this sector. The state owned enterprise sector was by far its most important financial resource, as well as financially the most demanding sector. Unfortunately, with this proposition the biggest hurdle was still left to be taken: the actual implementation of the reform proposals. The remaining measures proposed by Deng all involved relatively low political costs and had a much better chance of successful implementation.

3.3 *Agricultural reforms: the household contract system*

In agriculture, the reform situation created the momentum for the local bureaucrats and communes to start with various reform experiments. Whether the leadership feigned ignorance over these experiments; whether it was a rational process; or whether they just were not interested enough in agriculture because they had many more pressing issues to consider, remains unclear. The result, however, was clear. Agriculture was given the opportunity to reform itself bottom upwards. Successful experiments were promoted, unsuccessful ones were dropped.

The political risk of experimenting seems to have been rather low. Success at the bottom would ensure pressure on political adversaries within the leadership, as well as among the other influential interest groups, to give up their opposition. In the case that political opposition to one experiment would be too high, the leadership could easily stop it. Success would also enhance the legitimacy of experimenting with other reform measures. Also, the

financial risk involved seems to have been relatively small. The leadership's financial interests in the agricultural sector were the least of all economic sectors. In 1978, the importance of the agricultural revenues on the state budget were still very small: 3% of total revenues (Table 8). Neither did the government spend much on agriculture: 7% of total expenditure (see Table 5). More than 90 % of the agricultural earnings were retained by the collectives and individuals (Shirk, 1993, p.237). Only when the actual harvest nation-wide failed to materialise as a result of the reform experiments would the leadership have to import food for higher world market prices.

The experiment that was to have most influence on the agricultural reform process started at the very beginning of the reform process in Anhui province and was named the 'household contract system'. In this province, communes decollectivised their lands to the households via leasing contracts. The contract obliged the farmer to sell a production quatum to the authorities against planned state prices. Any production surplus the farmer could sell either to the state or on the free market against (higher) free market prices. Where implemented, this contract system produced tremendous growth figures. This induced other communes around the country to take on the same scheme. However, only in 1981, after the system had spread like wild fire through China's agricultural system, the political establishment was forced to formally implement this scheme. If anyone in the leadership and the bureaucracy had previously been opposed to it, the system's popularity stopped them from opposing its official implementation (Kelliher, 1992, p. 55).

Although the extreme communist ideological approach to agriculture in the form of the self-sufficient commune system was side-stepped within the household contract system, it did not contain a complete denouncement of state regulation. The nature of the new system

was semi-mandatory, meaning that the leadership remained able to return to a fully mandatory system fairly easy. It was especially in the second half of the eighties and the nineties that this opt-out clause was used by the leadership. Therefore I deem it necessary to give a short explanation of the working of the contract system. An additional reason to focus my attention on the contract system is that in later years many of the other economic sectors based their reforms on this scheme.

The house hold contract system had several different types, but the most important one was the 'quota contract' variant, connecting the income of the household with the output it produced. By 1982, 92% of the production units had made the transition to the contract responsibility system, of which 88% were in the form of the quatum contract variant (CSY, 1992). In order to carry out this latter variant, the production unit needed to divide its collectively owned land, stock and means of production amongst its members. The division of land was pursued by taking into account not only an equal distribution in the land seize, but also a fair distribution of the quality in lands. This policy resulted in the distribution of the lands in numerous small plots. An average family received 0,56 hectares of arable land, scattered over ten plots (Ling, 1991, p.15-16). Initially, the lease rights were handed over for a period of 5 years and were extended to 15 years in 1984 (Shirk, 1993, p.38).

The major part of the contract price was a land tax (normally a certain quantity of agricultural products) and the obligation to sell annually a quota of agricultural goods to the state against a state procurement price. As this price was below the real market price, the quota system was an indirect taxation mechanism. The quota had to be sold to the production unit which sole function now had become the agricultural administration. They, in turn, had

to hand it over to the local bureaucrats upon which it would follow its way through the bureaucratic levels which would redistribute the grains throughout the country. Further contract payments consisted of contributions (taxes) to the local state funds that were used for local construction works, infrastructure and education.

When the farmer had paid over his quota and taxes, and still presided over a surplus in agricultural output, he had two options. Either he could sell it to the state for a mutually agreed price or he could sell it on the free market. The state was obliged to buy against negotiated procurement prices (above-quota prices)²⁰ as much of the production surplus the farmers wished to sell. These prices always exceeded the regular state procurement prices (quota prices) by a considerable amount. How much the free market prices differed from these negotiated procurement prices is not exactly known. Detailed information on free market prices have never been released, but indications are clear that they were above the negotiated procurement prices (World Bank, 1991, p.109). Free market prices were not exactly 'free'. State interference with these prices only gradually declined and were often reinstalled when the inflation started to surge.

The free markets had been prohibited for most of the previous period 1967-1977. Consequently, the lifting of the ban on free markets produced a 200% growth in rural free markets between 1978 and 1987: 33.300 in 1978 to 67.000 in 1987. (Guohua & Peel, 1991, p.193-194). Important in the liberalisation of trade and the functioning of the free markets were the lifting of the majority of the restrictions on private long distance trade. Private individuals were allowed to specialise in transport and trade. The restrictions were lifted for

²⁰ Shirk, 1993, p.39: "From 1978 to 1982 the procurement process for the mandatory quotas of grain, cotton, and edible oil were raised by 26, 20 and 24 percent respectively, while above-quota state procurement prices were raised by 45, 56 and 43 percent".

all farm products, except grains. By 1984, the value of free market transactions was equivalent to 32 % of the total value of marketed agricultural products (Sicular, 1992, p.34-37).

Despite the fact that the regular state procurement price and state negotiated procurement price were set below the free market price, the household responsibility system did produce Deng Xiaoping's reform objective. Up to 1983, the contract system had positive results for most interest groups involved:

- Farmers had regained some freedom for their production. Although the larger part of their produce was sold against the lower state prices, they were able to sell any surplus against free market prices. The farming population reacted positively and total agricultural output rose on average 6.8% annually between 1978- 1982 (see Table 3). Consequently, so did their income. This in turn meant that around 70% of the population saw an increase in their standard of living.
- Local commune leaders could designate themselves the best pieces of land.
- Local officials could raise their (il)legal taxes as rural income had risen.
- Agricultural income rise also resulted in a higher demand for consumption goods and agricultural machinery which was good for the industry. At the same time, as the supply of these consumption goods lagged far behind the demand, rural savings rose tenfold between 1977 - 1982 (CSY 1992, p. 253).
- The consequent real rise in the food prices (most notably grains) were not brought forward to the urban consumers. The only result for the urbanites was thus a food supply rise.

- The leadership itself benefited politically from the success, but lost financially. The result of the increased urban food subsidies was an extra drain on the state budget. Between 1978 - 1982 subsidies rose 1959%. When in 1978 only 1% of the budget expenditure went to urban subsidies (of which the majority was on food), by 1982 this had risen to 15% (see Table 5). Apparently, the political opposition to a rise in urban food prices was so large that the leadership was forced to take this financially irrational action. The gain, however, lay in the success it had been able to establish. This provided the leadership with a much sought after increased legitimacy of rule.

The first real problems the leadership encountered with this newly introduced agricultural system was when China found itself in a situation of grain surplus, caused by the bumper harvests of 1983 and 1984. Under the reformed procurement system, the state was obliged to buy as much as farmers wished to sell of their production surplus. When in the period of 1983-1984 the farmers produced far above their fixed grain quota, the state ended up buying a huge additional quantity of grain. This caused a considerable unexpected drain on the central government's budget. The leadership was still not willing to shift this budgetary burden onto the consumers in the cities. But by now, the losses made on the food subsidisation scheme were becoming even too high for a politically risk averse leadership. The percentage of total fiscal expenditure on food subsidies for both 1983 and 1984 was at 14%, or 3.9% of the national income (see Table 5), while the agricultural budget contribution remained at 4% .

Conclusively, the first agricultural reform period ended with a strong agricultural growth. During the period 1979 to 1984, real growth in gross agricultural output value was

annually around 8%. Sideline production had grown annually by 15.3 %, starting with a negative growth of 3.5% to a positive 33% in 1984 (adapted from CSY 1992, p.299). However, this period also ended with a financially disastrous outcome for the leadership due to the agricultural and food subsidisation system which financially could continue to drain the state budget if no subsequent alterations were made. Still, politically speaking it had assembled a high gain for the leadership.

3.4 Industrial reforms

The importance of the industrial sector has been addressed in most of the previous chapters. In 1978, the leadership's budget revenues were for 86 % dependent upon the state owned enterprise sector. Due to the declining profitability of this sector and the pressing need for the leadership of additional financial resources, it was clear that something had to be done in order to make the overall industry profitable again (see Table 10). Unfortunately, the possibilities open to the leadership were comparatively few. The 'state owned enterprise playing field' for the leadership was very narrow. The technical, political and resource constraint were especially strong in this sector. And secondly, the interests both politically and economically of the bureaucracy and the military in the state owned enterprise sector were very large. The state owned enterprise reform period of 1978-1984 became marked by a constant battle between the different interest groups over the direction and content of the reforms. The proposed measures reflected the difficult situation the leadership was in. It simply was not able to implement a radical change within the state owned sector, even if it

had wanted to. Not in the least because the interest groups had representatives within the leadership itself.

In the first years, reforms in the state owned industrial sector were brought forward on an experimental scale only. Zhao Zhiyang, the Communist Party's first secretary of Sichuan province, introduced in his province an industrial experiment with profit retention. The enterprises, that were authorised to take part, were allowed to retain a larger part of their own profits. What made the results of this experiment questionable, however, was the fact that they were favoured in the distribution of materials, electric power, and bank loans. And lastly, the state owned enterprises that were chosen were the most profitable and strongest ones in the province. Those that did not perform adequately were dropped from the experiment. Not surprisingly, this scheme became a great success (Shirk, 1993, p.199-206). Immediately the willingness of the other provinces to participate in the experiment increased. By July 1979, 3,358 enterprises had joined.

The main reason for the willingness to spread the experiments was that it shifted the emphasis from total dependency on the plan, to earning profits by selling on the free market. This created a vested interest in the continuation of the free market mechanism. This move gained Deng Xiaoping political support. The particular nature of the reforms created a lot of financial and political benefits for the local bureaucratic officials involved. "It was an effective way to tie the interest of local officials to the fate of the industrial reform drive" (Shirk, 1993, p.201). Also the state owned enterprise management and employees benefited financially.

The Ministry of Finance, however, was not too keen on the results of the scheme. The revenues did not increase enough, moreover, it declined between 1978 - 1981 (see Table 7).

In addition, there was no outlook on financial revenue improvements within the scheme. Voices of discontent could be heard among the more conservative individuals in the leadership who were concerned about the loss in decision making powers as well as financial resources for the central government. They won the debate and a new direction was proposed in 1980. The economy would be adjusted towards light industry, and the other experimental reforms would be put to a halt. The following reform period 1981 - 1982 did not show any significantly improved results and remained as erratic. Policies were constantly altered according to the interest group which had temporarily gained the upper hand in the leadership.

After much deliberation and infighting, the leadership finally came forward with its first more structural reform measure: the introduction of a profit tax system. The idea was to make enterprises responsible for their own profits and losses. This, was the thought, would automatically induce higher efficiency. The introduction was to be taken in two stages between 1983 to 1985. During the first stage, the larger part of the profits should be retained at the enterprise level, in return for the abolishment of the central government's investment contributions. The (large) enterprises' part of the profit, which had to be paid to the central government, was put in the form of a profit tax. This was set at a uniform rate of 55%. The rest of the profit was to be submitted to an adjustment tax. During the second stage, the prizes were to be rationalised, and the income tax would become progressive.

In practice, however, the mere technical complexity of the industrial sector prohibited a fast structural reform. "Industrial reforms are technically more complex because of the sector's greater complexity of inter-industrial forward and backward linkages, the diversity of technological and production processes, etc. Thus reforms in industry or commerce will have

much wider repercussions throughout the system, with a change in one variable generating disequilibrating impacts that cannot be easily anticipated or contained.” (Lin, 1989, p.105). In agriculture, the situation was much more simple. The production process did not involve much interaction with other sectors.

Secondly, the tax rates were adjusted by the provincial authorities towards the firm’s relative profitability, which most of the times meant a much lower profit tax rate. In other words, the latter group did not co-operate enough to result in a good execution of this tax scheme. The measures were probably perceived by many managers and local authorities as infringing too much upon their interests. Consequently, it were mainly the small enterprises that had to switch to paying all of their financial obligations in a progressive tax scheme. Retained profits by state owned enterprise went from 2 billion yuan to an estimated 31 billion yuan in 1984 (Byrd, 1992, p.4).

Thirdly, instead of spending the retained earnings on the officially designated productive funds (investment, maintenance, depreciation), the state owned enterprises spend it on housing, public facilities and their employees’ welfare. After having disbursed all their money, the enterprise found the solution for their current shortage of investment capital in bank loans. They started to engage into extensive use of bank loans for investment financing. This is in itself not a bad shift, unless the banks follow a too lenient credit policy. As this actually was the case, an even softer budget constraint developed.

The second stage of the profit tax scheme proved too controversial for the management and local authorities to agree upon. The price rationalisation process, which was supposed to take place before further tax reforms, was not fully implemented (Shirk, 1993, p.265). The high degree of monetization in the industrial and commercial sector made any

price reform technically, but also politically much harder to implement. In the rural sector the influence of prices are much smaller due to the fact that the “price effects are primarily on the output side.. given the predominance of remuneration in kind and the relatively low marketed ratios of total output.” But also influential is the fact that, “A larger proportion of the rural household’s basic consumption bundle (e.g. housing, food and clothing) is internally produced and is thus less sensitive to price changes” (Lin, 1989, p. 105). In the urban areas, the larger role of money meant a larger influence on both the house hold income as well as on the production process. Price reform was, thus, potentially dangerous for the social order in the cities (which is also reflected in the 2000% urban subsidy rise to counter food price rises, see Table 5).

The tax reforms themselves were neither implemented as originally planned. They certainly were no longer standardised tax rates. So much had been altered that yet again no real measure had been introduced which would address the underlying problems of the state owned enterprise sector. Consequently, “during this period the industrial net output maintained a growth rate that was almost the same as that of the pre reform period, indicating no improvement in the performance of the State Sector” (Lee, 1994, p. 185).

The objective of making all enterprises responsible for their own profits and losses was simply unattainable because of the persistence of the systemic structural deficiencies of the state owned sector (i.e. soft budget constraint, regulated markets and irrational prices). An enterprise’s claim of having to operate under unfair circumstances could often not be denied by the local authorities, resulting in a relaxing of the taxation and control rules. The continued disagreement among the leadership over the course of the state owned enterprise reform provided the managers and officials with another reason to obstruct measures it did not like.

Unfortunately, the proposed measures were such that the majority of the managers and local authorities indeed felt that its implementation would negatively influence their interest. Their mutual interest made these two groups powerful allies against the reform measures. Both industry and local authorities had a large voice in the decision making process (Liebertahl, 1988, p.216, 281).

Finally, another industrial reform policy was set up that in later years would have its real great impact: the opening of the special economic zones (SEZs). Aware of the technological arrears in the state owned industry, the leadership decided to catch up via foreign investments. For this cause, it opened four coastal zones to foreign investment. Special incentives were given to attract high technology and export-oriented industries. In the beginning of the eighties, the results of this policy were very disappointing for the leadership. Not many foreigners were investing, and if they were, it was more in the service sectors or labour intensive industries. There are different statistics on how much was actually invested and on how many jobs the zones created, but the overall impression is that in terms of output was not significant. However, it did produce another important result: the opening up of China to the outside world. Whereas before Mao had conducted a very isolationist policy, Deng set the country open to outside influences. In general, foreign investment tends to go hand in hand with the arrival of foreign cultures. This also happened in China. But the effect on the different constraints as well as on the balance of power was still minimal.

3.5 The People's Liberation Army

The exposition of the balance of power in Chapter 2 explained the importance of the military for the leadership. They had helped the leadership to power, and by the same token had the ability to dispose of them again. In his reform proposals Deng did not leave the military out and announced its modernisation. Deng's next move was to replace ten of the eleven regional military commanders to gain firmer control. The heavy losses and casualties inflicted upon the military during the Vietnam war in 1979 took away most of the opposition to Deng's plans.

The military had believed that they could easily win the Vietnam war as they had so much more manpower and arms. The end result was different though. The war revealed the inadequacy of their forces as well as the inferiority of their arms compared to those of the Vietnamese. Although the war was won in the end, the disastrous costs created the conviction that modernisation and professionalisation were necessary (Blecher, 1986, p.202).

This situation had a profound effect on the power struggle that was still going on between pro-reform Deng Xiaoping and conservative Hua Guofeng. The military now proclaimed their backing of Deng Xiaoping and his pro-reform faction in the leadership. By 1980, Hua Guofeng had lost most of his power.

With hindsight I can see that the leadership tried to lessen the influence of the military at the decision making levels. Firstly, the military was given the lowest priority in the reform process (Dreyer, 1993, p.255). Secondly, by 1982, Deng had the central command under his control and his supporters in key positions. Thirdly, the Central Committee of 1982 had less than a quarter of individuals from the army compared to a third in 1977 (Blecher, 1986 ,

p.204). Further efforts were made along the lines of a reworking of the strategic doctrine, more attention to training, efforts to acquire more advanced weaponry, reorganisation of the PLA into a smaller, younger, more responsive and qualified force.

Quite surprising was that despite these goals, the official state budget expenditure on the defence went down from 1979 to 1982. It only gradually rose in the years after. Whether the statistics reflect a true picture of the real and total expenditure remains questionable, but it is certain that less emphasis was given to the military. According to Pollack (1992, p. 153), the Party and the military had achieved “a compact or at least a tacit understanding; in exchange for obeisance to CCP rule the PLA remained emperor of a vast realm of its own.... The Party very rarely intruded upon the societal, organisational, and economic domains controlled by the forces”. Under Mao’s self-sufficiency philosophy, the PLA had acquired all kinds of industries and even agricultural production facilities. The PLA formed more or less a separate state, with its own economy, within the Chinese state²¹. It would be in the later reform years, especially the beginning of the nineties, that this tacit agreement and organisational structure would give the military the freedom to act in the free market.

3.6 *Changing constraints and the balance of power*

Having drawn up the playing field and pointed out the difficult reform areas in the previous chapter, this chapter analysed the actual moves the leadership made. Linking this

²¹ This ‘tacit agreement’ would create the opportunity for the military leaders in the next phase of the reforms to set its first steps towards the free market.

reform period back to the assumptions made in the framework (Chapter 1.7), one can reach several conclusions. It was indeed the case that the Chinese reform plan was vague and certainly not built on a macro coherent strategy (Lin, 1989, p.109) (Assumption 8). It also proved to be extremely difficult for the leadership to restructure the state owned enterprise sector. Although experiments were performed in this sector and new reform measures were introduced, the actual changes were small. In practise there was too much resistance from the bureaucracy and the management of state industries against the financial effects of the measures. This led the leadership to provide an additional ‘cushioning’ measure. Therefore, the financial benefit to the leadership mounted to nearly nothing (Assumption 2, 3, 12).

Exactly the opposite occurred in agriculture. This sector seemed to have been able to develop due to the fact that the interests of no influential interest group was on the line. Only after the household contract system had already become successful was the leadership confronted with some of its negative aspects. The system resulted not only in a rise of output, but also in a strong rise of the agricultural output price. In turn, the system forced the government to buy more and hence to spend more than planned. The incredible increase in the urban subsidy scheme of 2000% in four years seems to support the assumption that urban food price rises are politically costly to such an extent that most governments would rather create a budget deficit and increase urban food subsidies than opt for potential urban unrest (Assumption 3). Nevertheless, the success of the agricultural sector did give the leadership the legitimacy it had been seeking. In addition, it gave the process more credibility among the people (Assumption 9).

Finally, the changes that took place in the playing field need to be addressed before I can continue with the following reform period. During this first reform period 1978 - 1984, the field's boundaries seem to have altered somewhat. With hindsight, one can say that during this period, it was more the case that the ground holding the fence poles had started to loosen than that whole fences were being rearranged (Assumption 11). After Deng had gained the upper hand in the leadership and Hua was relegated to the background, Deng tried to address the political constraint the leadership was under. In 1982, he introduced measures to streamline the Communist Party and the bureaucracy. The objective was to return to a conventional way of governing, closely related to the prevailing communist model of the fifties (Saich, 1983, p.10). He wanted to realise a rejuvenation of the Party and attract more intellectuals. It was felt that "...the aims of many of the reform were being blunted by a large number of leftist. Many of them poorly educated, who were entrenched in the bureaucracy..."(Dreyer, 1993, p. 158). One of the important measures that was actually passed concerned the retirement of elderly seniors of the Party into an advisory group. Most agreed, but they insisted on appointing their own successors. The result was that behind the scenes this advisory group kept the paramount power. Thus, the higher echelons of the central government expanded instead of being reduced. Even so, in 1985 the average age in the Central Committee was 73 years, and in the Politburo 75 years (Blecher, 1986, p. 109). Conclusively, the political constraint remained strong.

In 1984, the technical constraint was largely the same as in 1978. The command economy had not been denounced, and the largest sector (state owned industrial sector) had only slightly been restructured. The reforms in the agricultural sector had been extensive, but a true break away from the command economic system had not been accomplished.

“Although agricultural reforms entail[ed] fundamental changes in income rights introduced through the devolution of decision making powers to the household and through a concomitant extension of market relations, property rights remained unaffected” (Lin, 1989, p.104). Nevertheless, the agricultural reforms had resulted in the reinstatement of rural free markets.

The resource constraint on the other hand was strengthened during this period. The state owned enterprise sector was not reformed, and thus provided no new financial resource opportunities. Moreover, their profitability went down. Neither, did the agricultural sector reforms supply any new financial resource potential, and despite the agricultural growth, it did not transfer any more income to the budget. In all, the appropriability of the leadership was not improved. In addition, the rise in urban subsidies created an even higher strain on the budget. Its inability to cut the budget deficit and raise its appropriability forced the leadership to gather the necessary financial resources by seignorage and borrowing on the international and domestic markets.

The last part of the playing field also saw some changes. Within the balance of power (Assumption 10):

- the bureaucracy had seen its power increasing as a result of the industrial decentralisation efforts. The agricultural reforms had changed the local bureaucratic structures with the break up of the commune system. Although the very lowest bureaucratic level might have lost some power (e.g. team leaders), it seems most likely that the bureaucrats from the village level upwards were able to keep their power position. This conclusion is also derived from the fact that the leadership had not changed the property rights and neither

had it truly broken with the agricultural command system. It needed the bureaucratic structure to keep the control.

- The Vietnam war led to a stronger backing of Deng Xiaoping by the military. With the military's consent, structural reforms were gradually implemented. Its budget allowance, however was not really cut, nor were their industrial interests curtailed. Their power position seemed to have remained fairly much the same.
- The management of the state industries saw their power increased. The industrial reforms and experiments in practice led to an even softer budget constraint than before. The result was that management on the one hand simply took up more debts and spend it on investments and workers' benefits (including their own), and on the other hand led the enterprises' profitability go down. This situation made the leadership even more dependent on the revenues of the state enterprises, and enhanced the political leverage of the management.
- The urban population did not gain any more power, but what it did gain was higher wages and other social benefits.
- Neither did the rural population gain any power. This group, however, did gain increased individual decision making powers over their production process and higher incomes.

4 Accelerating market liberalisation (1985 - 1986)

4.1 Introduction

The most important achievement of the first reform period was the success in agriculture. Although financially disastrous for the leadership, politically it gained them much credit. When neither the state owned industry reforms were producing any additional financial resources for the leadership, the green light was given to the resurrection of the collective industry's sector: the township and village enterprises. A momentum of change was created, and structural reforms in the fiscal and industrial sector were accelerated. Despite its previous importance, agriculture disappeared from the spotlight.

4.2 Fiscal reform

The need to reform the fiscal system was becoming more urgent because the local state revenues had been declining due to the new agricultural contract system. This latter system allowed farmers to retain more of their profits and at the same time forced the state to pay higher prices. After a period of trial and error in fiscal reforms, the leadership introduced a fiscal contract responsibility system organised along the same lines as the agricultural

and price systems.¹¹ Because contracting gave every organisation the opportunity to retain its privileges through bargaining, it was easier for contracting to win consensus of bureaucratic support than for inherently redistributive policies... The costs of continuing inefficiency were diffused among all economic actors, whereas the benefits of contracting were concentrated on specific enterprises and bureaucracies and potentially available to all” (Liebertahl, 1988, p. 281).

It was clear that any growth in the local rural and urban industry would give the localities and provincial authorities additional revenue possibilities. This new fiscal contract system in combination with previously taken measures concerning the lifting of trade restrictions, the opening up of free markets and the success of the agricultural reforms created the basis of promotion of and participation in these industries by the local authorities. When in 1984, the township and village enterprise reforms were introduced (to which I turn in the next section), it only took one year before the rural industry was booming and within its trail the local retained revenues.

The budget deficit of the government, on the other hand, did not disappear. A situation that was obviously not foreseen and certainly not planned to happen. Apparently, the leadership had not taken into account the fact that sufficient growth in its revenues at that time could only come from higher profits in the state owned enterprise sector. The profitability of this sector, however, remained its decline (Graph 10). Worse, the central government had to hand over increasing amounts of subsidies to these companies. A second cause of the government's worsening budget balance was inherent to the fiscal contract system. The taxes the provinces had to hand over to the central government would never be

more than contracted, but could always be less. As soon as one poor province would run a deficit and needed central support, the central budget would be negatively affected.

In 1985, the tax system was redesigned to address this last problem. The provinces whose local fixed revenue exceeded their expenditure needs were required to transfer excess revenue to the central government. The provinces whose local fixed revenue could not cover their expenditure were permitted to retain a certain proportion of shared revenue (Agarwala, 1992, p.x). Unfortunately for the leadership, these changes did not prevent the budget deficit from worsening again. According to Western accounting principles, the budget deficit nearly 8 folded between 1982 and 1986 (Table 5). The Chinese accounting principles, or rather their absence, and lack of central government control on local administration, left ample room for localities with a revenue surplus to perform 'creative accounting' in their local budget and let any revenue surplus 'disappear'. But as it was, the fiscal contract system exactly matched the leadership's constraints, and economically and politically it seemed to be the best the leadership could attain for itself.

4.3 *The township and village enterprises*

There had always been some industry besides the state owned enterprises, but during the mid-eighties the leadership started to recognise its potential as a source of revenue and employment. The continuing budget deficit, growth of indebtedness and decline in profitability within the state owned enterprise sector simply had to be turned around if the

leadership wanted to envisage a long term view on their finances. At the same time, the population growth of over 15 million a year was urging it to create an increasing amount of new jobs. The regular employer had always been the state owned enterprise sector, but by this time it had become clear that this sector no longer provided sufficient prospects of rising employment facilities. Small scale industry, on the other hand, did seem to have better economic growth and employment opportunities. Since 1978 - 1984 annual real growth in gross output had started at 11% and surged to 35% in 1984 (Table 3). During that same period, employment in the urban collective had grown by 57% and in the rural industry sector by 47%, compared to the state sector by 16% and agriculture by 9.4% . By 1984, these two sectors jointly provided employment for 57.65 million people compared to 86,37 million in the state owned enterprise sector (Table 9).

Industrialising the countryside would also create a strong incentive for the rural population to remain in their areas. Growing unemployment had led to an increasing illegal rural migration to urban areas. This was straining the urban infrastructure and food availability, and gave rise to potential social unrest. It was this latter situation that the leadership wanted to avoid by all means possible. Finally, it would provide the local governments the means to increase their own local tax revenues. This, in turn, would enable the leadership to reduce their remittances to the provinces.

These positive considerations induced the central government to pass new laws and regulations concerning the rural and urban industry²². Reforms that, in fact, complemented the fiscal reforms. They provided the local authorities with the income incentive (higher tax

²² Rural and urban industry is defined by some authors as the non-state or private sector. This definition, however, is too confusing as this industrial sector shows primarily some sort of collective ownership.

revenues and personal income gains) to co-operate and invest local money in the industry. The rural enterprise sector was the most important industrial sector to emerge. It was active not only in industry, but also in construction, transport and commerce. It comprised two different types. The first was the Township and Village Collective Enterprise (TVCE), which was **collectively** owned by an entire rural community and regarded as a local State enterprise (average employment of 50-99 persons). The second type consisted of various (semi-) **private** categories, such as co-operatives, partnerships, and private and individual firms (officially allowed employment was up to ten workers)²³.

In the urban industrial sector there were also two types that could be distinguished. First the **collectively** owned enterprises: enterprises that were affiliated with a district government under a municipality or a county, and enterprises established by a neighbourhood under a district. Second were the (semi-) **private** enterprises like urban co-operatives and urban individual enterprises. The employment conditions were the same as the rural industries.

It took a long time before the private industries contributed a considerable amount to the gross industrial output. By 1986, it still only produced 2.7% of this total (Table 1). I shall turn to a more in depth analysis of this sector when it has gained in importance for the leadership, which is at the beginning of the nineties (Section 5.5.3)

The rise of the township and village collective enterprises is described by Oi (1992) as a new institutional development that is characterised by a merger of state and economy. The

²³ In China's official statistics there are three types of ownership besides the state owned enterprises: "collective ownership", "individual ownership" and "other types of ownership". The urban and rural collective enterprises fall under the heading of "collective ownership" (Qian, 1992, p.7).

local governments took on many of the characteristics of a business corporation, with officials acting as the equivalent of a board of directors. She defines the industry as *local state corporatism*. The levers of governmental control on the township and collective enterprises were four fold:

1. **Factory management:** the contracting or leasing of local state enterprises to individuals rather than privatisation, facilitated local government intervention and control. The decision making powers remained with the officials.
2. **Resource allocation:** all the local township and village collective enterprises in one village should receive assistance from the local official. This official presided, as a result of the fiscal reforms, over a larger local state budget that he could spend according to his own criteria. The township and collective enterprises with the best economic performance could receive his preferential treatment in the allocation of key production inputs. Firstly, the official could give privileged access to those inputs that were supplied to localities under the central allocation system. This system distributed rationed inputs against state prices, which were below-market prices. Secondly, privileged access to inputs against market prices that were not rationed, but simply scarce.
3. **Bureaucratic services:** preferential treatment of township and collective enterprises was also performed by officials in differing the quality and quantity of the bureaucratic services they had to provide to the township and village collective enterprises. "The daily routine of leading cadres at the county-level township industry management bureau is filled with trips to the prefecture, even to Beijing, on behalf of a specific local enterprise" (Oi, 1992, p.121).

4. Investment and credit: Chinese banks do not operate on a full commercial basis like the banks in a market economy do. The amount that local banks can lend is determined by quotas set by upper-level banks. Credit thus becomes limited and a scarce good. A further complication for the township and village collective enterprises was created by the fact that the banks demanded local official approval and support for any requested investment loan.

The practical implication of the rural and urban industry reforms, as well as the fiscal system reforms, was that it provided the local officials with the freedom to act according to their own income optimising behaviour. They could spend all income, which came on top of their official budget, at their own discretion. The official budget had to be spent on designated areas. However, this loosening of the leadership's control over local spending also resulted in a lessening of the control over the official budget spending. This caused a negative aspect to arise in many provinces; the diversion of designated agricultural sources to the more profitable rural enterprise sector. Agriculture had become the least desirable investment option for the local officials, as it would heighten the farmers' income and not their own.

The profitability of the township and village collective enterprises for provincial authorities lay in the fact that they could tax them largely according to their own rules. The two most important taxes were the enterprise income tax and the tax on value added sales (VAT). The latter tax consisted of 75 % of the total tax payment. In addition to these tax revenues, the bureaucracy could as the legal owner of the township and village collective enterprises, legitimately extract non-tax levies. (Oi, 1992, p.116).

The incentive for officials of all ranks to stimulate the rural enterprises was made stronger by the linking of a bonus pay to the performance of the township and village collective enterprises in meeting profit and production quotas. Officials at each level of government set production quotas for their subordinate levels. If the enterprises for which they were responsible failed to meet the quotas, each bureaucratic level would hold part of, or the entire bonus back. The provincial government held back the bonus of the county, and the county of the township-level officials, the township-level officials of the village-level official.

The employment expectations were met. By the end of 1986 rural industrial employment had grown by 23% from 1984. Even better employment growth figures came from the supporting rural sectors of transportation, construction and service industries which grew between 1984-1986 by around 60%. During the same period the state owned enterprise sectors only saw a 6% growth rate (Table 9).

The actual production figures were also promising, especially compared to the real growth in state owned enterprises' gross output value of around 10%. Real gross output growth of the collective owned industrial sector was in 1984 - 35%, 1985 - 33% and 1986 - 18% (Table 3). The only unfortunate result for the leadership was the disappointing additional remittance to the government budget. The collective industry's contribution only rose from 14% in 1978 to 16% in 1986. These official figures, however, do not reflect the extra-budgetary resources which were retained by the local authorities. The leadership nevertheless had to find a new way to siphon off some of the profits made in the collective sector.

4.4 Contract responsibility system in the state owned industry

All in all, the profit tax reform had not produced a more profitable state owned enterprise sector. When by 1984, the government's budget still had not improved much, the need for the leadership to make progressive reforms in the state owned enterprise sector started to become more urgent. It needed increased revenues and less financial liability from the state owned enterprises, and at the same time it needed this sector to balance its budget and reduce its borrowing spree. The reason for this was the inflationary threat that was building up in the economy. Prior to 1979, money was of relatively little significance for acquiring entitlement to goods, especially in rural areas. During the reform, however, the economy became increasingly monetized, with cash transactions playing a much larger role. Within the state owned enterprise sector, the only way the leadership could lessen the inflationary threat was to achieve stronger financial discipline.

To this purpose, the banking sector had undergone extensive reforms. Heightened autonomy was to give them more power in their credit allocation and a more market oriented behaviour. Bowles and White, however, conclude in their research on the financial reforms that “... [banks] are not using that power to impose discipline on enterprises and thus the credit constraint continues to be soft.” (1993, p. 116). “In fact, the credit constraint may have become softer.” (p. 114). In practise, the banks could not withstand the demands placed upon them by the state industries. Their increased autonomy and changes in the institutional financial framework meant that they could distribute even more credit than before.

Firstly, this was reflected in the wage reforms. In 1984, wage reforms were put forward for 1985. They were to link the enterprise's financial results to its total wage bill. If profit remittances and tax payments to the central government increased, total wages were allowed to raise as well, usually in a specified ratio to the increase in taxes and profit remittances (Lin, 1989, p. 128). In addition, the total wage bill was no longer dependent on the number of workers employed. This meant that the average compensation per worker could increase by reducing the size of the work force and created the incentive to hire additional workers only when their additional productivity would not lower the average wage sum (Byrd, 1992, p.9). Attempts to introduce piece rate wages, which were used in the rural enterprises, had run into opposition of the workers themselves. Only 9% of the state owned enterprises operated on piece rates against 92 % of the rural enterprises.

The problem with this policy was the timing of the announcement. It gave the management of the state enterprises the incentive to quickly raise wages and bonuses, upon which the total 1984 national wage bill rose 75% compared to the previous year, which continued well into 1985. "The specialised banks responded to enterprise demand for more credit by extending more loans, as they too had been told that their lending for 1985 would be based on loans outstanding at the end of 1984.the underlying cause was the decentralisation of decision making to enterprises which allowed workers to seek higher incomes, often with manager's support" (Bowles & White, 1993, p. 105). Not surprisingly, of all economic sectors the real wages remained the highest in the state owned enterprise sector (Ody, 1992, p.13). Consequently, these wage reforms in practise produced strong inflationary pressures.

Secondly, the effects could be seen in the continuation of the high investment figures in the state industry. Despite the fact that the collective industry was developing fast and the continuation of the decline in state industry's profitability, the state industry kept up with the national investment growth and kept its share in the total investment expenditure above 60% (Table and Graph 13B). Bowles and White report on this that "Local governments were also in on the act, pressuring banks to finance enterprises and projects in their jurisdiction in order to promote local development. Local governments seek to maximise investment and growth locally, since their fiscal revenues and political authority depend upon the level of economic activity in their area." (1993, p. 105). As long as the central government bore the final responsibility over this sector's financial situation, the provincial authorities would not be very interested in active co-operation. The only thing that they cared about was that bankrupt or not, the state enterprises would be kept operating because they provided local employment, income and other social benefits.

Other measures that were taken during this reform period concerned employment security. One of the labour problems was that in the state owned enterprise no employee could be fired and that wages were rigid. This had created not only the absence of a performance incentive for the employees, but also an immense over-employment. The labour reform allowed the enterprises to employ new labour on a three year contract basis. Through that, the possibility was created to fire workers who performed badly. But, like so many other measures taken also this one did not appear to be executed. Soon the renewal of those contracts became near automatic.

By 1986, it was clear that new measures had to be taken. The leadership, inspired by the success of the agricultural contract system, introduced an **enterprise contract responsibility**

system. Corresponding to the other contract systems, this system included fixed profit remittance, retention rates and investment targets. Usually a contract was signed for a three year period. Production above the fixed profit remittance could be sold on the free market against free market prices (Byrd, 1992, p.8).²⁴ The problem remained with the continuation of governmental regulation. The government was trying to keep the inflation low. The 'free' market prices were higher than the state prices but were kept under a market clearing level. If an enterprise had high profits these would be taxed away again. It remained more profitable to strike deals with other producers or buyers for side benefits that would go to the employers. This caused a continuation of shortages.

Various **management contract responsibility systems** were also sought after to complement the enterprise contract system. The management contract was supposed to enhance the authority and performance of the enterprise directors, and thus enhance the enterprise performance. Although the government experimented with various systems, the results were not very satisfactory. They only received some success in the small scale state enterprises. The leadership then proceeded with a restructuring of the state ownership. Albeit no privatisation, but **marketisation** of the ownership responsibilities among management and the supervisory government agencies. More advanced **management contract responsibility systems**, like leasing contracts, were implemented; experiments were conducted with share ownership; and, especially in the retail commerce sector, some smaller firms were privatised.

²⁴ By 1988 over 90 per cent of the state owned enterprises were operating under this system, and by the end of 1991, most had signed a second contract (World Bank, 1992, p.45).

Finally in 1986, the leadership also installed a new bankruptcy law. This was to give the banks additional leverage over the enterprises. As far as the success of this reform and the new contract reforms are concerned, I will analyse those in the next chapter.

4.5 Further agricultural liberalisation

The success of the agricultural reforms led most people to believe that the agricultural sector had found a dynamism of its own that kept placing its real growth rates above the planned rate. This belief made the politicians worried over a possible continuation of the unplanned, unexpected agricultural budgetary losses that they had encountered with the bumper harvests of 1983 and 1984. To get out of this deadlock, the leadership was faced with a choice between agricultural recentralisation or further liberalisation. The choice fell on a continuation of its retreat from the agricultural economy. It was planned that a reduction in the urban food price subsidies should complement the central government's retreat and restore the fiscal balance.

Thus in 1985, the government announced a new procurement system that had to replace the obligation of the farmer to sell fixed quotas of agricultural products to the state. The state commercial department was supposed to consult farmers before the sowing season. The farmer could then choose whether he wanted to sign a contract and have guaranteed sales, or sell his products on the free market for free market prices and pay his contract fees directly in money. If he went for the contract, the price the farmer would receive for his delivered output would be set at new **proportionate prices**. These prices were agreed upon when signing the

contract *before* the sowing season. These prices were single prices, equal to a weighted average of regular state procurement and state negotiated prices. If he chose the contract, he could still sell any surplus either on the free markets or for free market prices to the state. (Xiangliang, 1990, p.41; Sicular, 1992, p.44). Besides the contracted amounts, the state was no longer obliged to buy all produce offered to him. This would prevent the reoccurrence of situations that had arisen in 1983 and 1984.

Although theoretically, this procurement scheme was a great improvement over its predecessor, again, it depended heavily on the right price setting. And this was exactly what the government failed to accomplish. The new proportionate prices of the most important agricultural crops -grain and cotton- were put too low in comparison with their free market prices and the market prices of cash crops²⁵. In addition, the **planned** input prices of fuels and fertiliser had been rising gradually since 1983, while subsidised fertiliser schemes had been abolished in 1985. This input price rise was also heightened by the allowance of free market trade in agricultural inputs, which allowed the trade of imported fertiliser at unsubsidised higher market prices. If farmers needed additional inputs and could not buy them through state channels, they were forced to pay these higher prices that were sometimes between 50 to 100 % above the state price.

Farmers, finally having the freedom to act as rational profit maximisers and treat the prices as their profit indicators, reduced the amount of farm land sown with grain²⁶ and cotton. The profitability of these crops against other agricultural products had eroded too much. The real income rise of the urban coastal population had created a growing demand for

²⁵ Cash crops: oil seeds (peanuts and rape seed), sugar cane, beet roots, cured tobacco, fruits.

²⁶ The Chinese definition of grains contains: rice, wheat, corn, sorghum and other mixed grains; potatoes and tubers. Five kilos of potatoes are compared with one kilo grain (Etheridge, 1988, p. 158).

the higher priced cash crops. Farmers, especially in the east of the country, could switch to more profitable agricultural products, like fruit and meat. The sown areas for cash crops compared to the total sown areas increased from 5.5 % in 1984, to 9 % in 1985 and 10.4% in 1986.

In principle, this switch did not need to be received negatively by the leadership, but it was. The reason for it was that China needed to feed nearly 25% of the world's population with the proceeds of only 7% of the world's arable lands. In addition, the amount of per capita arable land had decreased by 45% in China in the past 25 years, with its decline accelerating. Already under Mao, the leadership had started to put the emphasis on grain production as this produce contains the highest energy and protein per hectare. This policy resulted in grain production occupying 80% of the arable lands in 1978. In 1986 this figure was still high at 77%, but grain production growth was increasingly volatile. A constant growing grain supply was important for two reasons. Firstly, otherwise China had to import more expensive grain from outside. In turn, this might make it dependent on foreign countries. Secondly, the distribution of grain to the inland provinces would make it even more expensive.

Within agriculture, stagnation in land productivity growth was another important factor of concern for the leadership. At the end of 1986, it seemed that the institutional reforms of this period and of the preceding period had not created a radical change in the agricultural organisation towards a modern agriculture society. Instead what had taken place was a return from centralised traditional agriculture back to local traditional agriculture. An important hindrance towards the modernisation of agriculture and rising land productivity was the present land use. The small farms, whose plots were scattered over a vast area, withheld any

development of increasing returns to scale. Production growth by technology improvement on such small plots was also hard to accomplish (Feder, 1990, p.32).

Efficient reallocation of the different plots was not attainable for several reasons. Most importantly, the state remained the legal owner of the lands. Although the state had extended the lease on the plots for a period of 15 years and from 1987 upon, even for 20 up to 50 years, it still was impossible to buy the land of the production unit. Nor was it inheritable.²⁷ Other reasons were the absence of an effective land tax system, a national standardisation of the leasing system, a land registry to regulate land mobility and a social security system (World Bank, 1991, p.7). This last reason caused farmers, who had started working in industry not to transfer their plots, but to keep them as a security against unemployment. These (former) farmers could not cultivate their plots efficiently due to a lack of time, causing low land productivity. Thus, unfortunately for the leadership, the expected continuation of agricultural output growth of around 9% did not take place in the mid-eighties. A general slowdown in output growth to 3% occurred, with great deviations among the different agricultural sectors (World Bank, 1992a, p.246).

Despite the further liberalisations in the agricultural sector, the leadership did not proceed with a more rational organisational restructuring and total price liberalisation. The political costs of such a policy were too high, and the economic gains too low (Kelliher, 1992, p.141). On the one hand this was reflected in urban subsidies which remained to take up 15% of the budget only to come down to 9.7% in 1986. On the other hand it was reflected in the low fiscal revenue contribution of 3.5% made by agriculture (Table 8). The medium

²⁷ According to the World Bank, land reforms were supposed to be underway since 1988, but had not yet been carried out by 1991. When activated, these reforms are supposed to enable the legal transfer of land rights (World Bank, 1991a, p.7).

term problem of retaining a constant grain supply, apparently was not acute enough for the leadership to undertake any action.

4.6 *Special Economic Zones*

Despite its original aim and subsequent efforts, the government had not been able to attract high technology foreign investments. Nevertheless, instead of disabandoning the policy, the leadership expanded its scope. In 1984, it established in sixteen coastal cities Economic Development Zones (e.g. Dalian, Shanghai, Tianjin, Guangzhou). These cities were granted some of the advantages the Special Economic Zones had been given. By this time, the agricultural sector reforms had become a success and the rural and urban industrial development process was making a head start. The reforms in these latter sectors provided the opportunity in both the Economic Development Zones (EDZ) and the Special Economic Zones (SEZ) to make even better use of their special privileges and comparative economic advantages (location, abundant, cheap, and also educated labour). By 1985, the leadership accepted the reality and changed its development approach towards the promotion of more labour-intensive and low-tech industry. The provision of these new investment opportunities induced increasing amounts of foreign investors to turn to China. Apparently, the disadvantages of the earlier years were gradually overtaken. Especially, Hong Kong, Taiwan and Japan started transferring some of their labour intensive industries to the Chinese coastal areas. Notwithstanding the national and international attention the development zones

received, the importance on the growth of the economy was still relatively small. In 1986, foreign investments had only risen up to 3.4% of total investments in fixed assets. The main influence remained with the trickling through of western cultural and moral ideas to the Chinese society.

4.6 *Changing constraints and the balance of power*

My analysis of the reform process during the period 1984 - 1986 started within an altered playing field. The impact of these changes on the leadership's reform ability was not large. Many of the obstacles to reform as analysed in the previous chapter, also kept its influence during this period.

The most influential reforms that were implemented were the fiscal and collective industry reforms of 1984. The rural financial savings surplus from the agricultural success of the previous reform period, the increased credibility of economic reform process' continuation, in combination with the fiscal and collective reforms provided both the local bureaucracy and population, the economic incentive to participate and/or stimulate the urban and rural collective industries. These industries were allowed to produce for the free markets. Profits could largely be retained at the local levels as extra-budgetary revenues. This sector operated without the social benefits of the state industries and job certainty, but with piece rate wages. Most had a large dependence on the local bureaucracy for management, resource allocation, bureaucratic services, investment and credit. The background to this success was that co-operation with these reforms did not affect anyone's power position, but co-operation

might potentially gain them money in the form of profits and higher income. In other words, the rural and urban collective enterprise reforms tended to portray a positive sum game (Assumption 4). Politically it was viable for the leadership to implement these two reforms, economically they were also rational although their financial benefits to the central government were not extensive.

Only after the realisation of the success of the collective industries was the political momentum created for a more structural change in the state owned enterprise sector. The modified economic environment had not altered the state industries' interest, but had changed their possibility set to achieve this. Similar to the agricultural contract system, the proposed and implemented state enterprise contract system provided the state industries with the option of selling part of their products on the free market (Assumption 10). However, the wage, labour and bankruptcy reforms were opposed, altered and, in practise, not implemented (Assumption 12). The political costs of these latter measures seemed to overtake their economic rationality and potential financial and efficiency gains.

In agriculture, the choice was made to continue to liberalise the contract system. The results, however, were dependent on the real realignment of the state agricultural prices (especially grains and cotton) with the free market prices. This, however, would only be financially advantageous for the leadership if it was able to pass on the charges to the urban consumers. However economically rational it was to cut the urban subsidies and raise state agricultural prices, politically it was not feasible (Assumption 2). Complementary reforms that were necessary to further liberalise the agricultural sector, like land property, land tax, and land registry reform, did not materialise.

Also during this period (1984-1986), the reforms and their results modified the leadership's playing field. The prevalent economic relationships altered extensively after the resurrection and expansion of the collective industries, the expansion of the free markets, and the fiscal reforms. This, de facto, meant a considerable change in the technical constraint by making it less rigid. On the one hand, the leadership had less control over the market forces, but on the other hand, the free market was able to solve some of the shortages that the planning system had not been able to accomplish. Nevertheless, the dominant role of the state owned industries and of the planned economy was not renounced.

Alongside the changes in the technical constraint were those in the resource constraint. In 1984, the first real head start was made with fiscal reforms. Similar to the agricultural reforms, the success involved a contract system. Many items were designated as extra-budgetary revenues, which provided the bureaucracy with the means to retain large parts or all of the local collective enterprises' profits. Although this fiscal scheme potentially could generate increased tax revenues, it depended on strong national control and increased profits in the collective as well as the state sector. This was not accomplished. The budget deficit declined from -12,173 million yuan in 1984 to -6,825 million yuan in 1985, after which it jumped more than eleven fold to -85,831 million yuan in 1986. The alarming issue of this deficit was that only 16% was financed by international and national borrowing, the rest remained unfinanced. This was an unprecedented high of 11% of the National Income (see Table 6). In combination with the results of the state industry reforms during 1984 - 1985, a strong inflationary pressure was building within the economy (Bowles & White, 1993, p. 110).

Within the political constraint the fundamental problem of the reform process remained the prevailing consensus - decision making process. As Liebertahl explains it, “Even once a policy is formulated and adopted, the implementation process is characterised by negotiations among and between levels of the hierarchy, sometimes all the way down to the grass roots. Each level slightly deflects policy in a direction favourable to its interest; by the time one has moved through six, seven or more layers of the system, the cumulative distortion can be great. Almost, invariable, unanticipated and unwelcome consequences are part of the implementation process from the leadership’s perspective.” (Liebertahl, 1992, p. 57).

Lastly, the balance of power also underwent some changes during this period:

- Only the bureaucracy saw their power extensively altered as a result of the fiscal reforms; its power was increased. In combination with the collective enterprise reforms, the fiscal reforms created a steep rise in financial taxing ‘opportunities’. A situation that seemed to translate itself into favourable conditions that nurtured corruption. A reflection of this is the bureaucratic expansion that had taken place. By the end of 1986, the total staff of ‘government agencies, parties and social organisations’ had grown with 87% from 1978 onwards (CSY 1992, p. 80), and government expenditure on administration had risen by 271% (Table 5, Graph 4) (Assumption 4).
- Not surprisingly, the discontent about bureaucratic corruption in combination with the economic situation grew among the urban population. In that same year, this culminated in the first student protests of the Deng reform era (Dreyer, 1993, p. 161).

- The collective industry reforms also provided the rural population with the means to enhance their income. However, it were mainly the coastal rural areas that were able to benefit from this policy.
- The leadership started an institutional reform process in the military establishment halfway through 1985 which basically included efficiency enhancing measures and a slimming down of the officers' corps. Specially “ the retirement was resisted because of the decline in status and the lack of protection against inflation” [in the provided compensation packages] (Pollack, 1992, p. 159). Deng continued to bring the military representation within the Party down, in order to depoliticise the military. “In 1985, there were only four members and one alternate member from the military on the politburo” (Lee, 1989, p. 235). In my opinion this did not undermine the power position of the PLA much within the balance of power. Professionalisation and modernisation continued. Many younger people were rising throughout the ranks to the second and third echelons.

5 The austerity program and Tiananmen Square (1987 - 1991)

5.1 Introduction

In all, the economic reform process was producing abundant positive factors like new jobs, higher real income, savings, and investments. Undoubtedly the standard of living had risen for most people. Perhaps the most important event was the increase in credibility of the reform process. Since 1978 the leadership had continued to execute its reform intentions, and by 1987 it was easier to believe that the leadership would keep its word to remain committed. This was especially important for the investment growth in the rural and the upcoming collective and private industries. By now, also the rest of the world started to take a more genuine interest in the progress of the Chinese economic reforms and the possibilities that direct investment could offer them.

The leadership's possibilities for reform remained restricted. It was still bounded by its playing field. A field that it did not seem to be able to change much to its own advantage. Between 1987 - 1991 mounting corruption and inflation led to a growing discontent among the urban population. In 1989 this led to the most lengthy and ardent student demonstrations China had seen since 1978.

5.2 *Return to mandatory planning in agriculture*

In the second half of the eighties, the focus of most people, nationally and internationally, was at the fast growing, money making township and village enterprise sector. The reforms in the agricultural sector, however, were equally influential on the welfare of the people and economy, albeit less positive. In 1987, the agricultural sector was about to take two steps back in its reform tracks. With around 58% of the labour force earning their living in agriculture, this was a serious event (Graph 9).

The liberalisation reforms in agriculture had missed their target. Output growth of grain and cotton had not continued to improve much. In order to forestall a decline in growth, the leadership had to retreat from its present reform path of 1984-86. Either the agricultural sector had to be liberalised completely with total free input and output markets as well as the introduction of private property rights, or the sector had to be brought back under direct Party control. Despite its economic rationality for the leadership's budget, the first option was politically a very expensive one as it meant the abolishment of urban food price subsidies, and a congruous rise in urban food prices. The second option did not have much economic costs nor much political cost due to the virtual inability of the agricultural population to voice their dissatisfaction.

The second option was chosen. In the household responsibility system, the choice between voluntary grain contracts or free market production sales was abolished. The voluntary contracts were made mandatory again. The local bureaucracy and production units were, as in the former Mao era, put under the obligation to deliver fixed grain quotas to their superiors. Restrictions were put on free market sales of grain, and in 1988 the central

government resumed its monopoly on the procurement of rice. The leadership also re-established its monopoly on the inter-regional distribution of grains and fertiliser, as well as on foreign grain trade in 1989 (World Bank, 1991, p.6). Another measure to induce grain and cotton production growth was the rise in (proportionate) procurement prices. This rise was again not high enough to offset the rise in their free market prices. More than half of the grain procured by the government was purchased at below market prices (World Bank, 1991, p.18).

There are some other factors that might have played a role behind the decision to choose this agricultural redirection which argue from a more positive standpoint concerning the motives of the leadership. Firstly, a clear indication of the agricultural real income was not available. The pricing system of agricultural input and output had become so confused that it was virtually impossible to calculate the real agricultural income. Secondly, rural income had risen sharply due to the rural industrialisation process. This non-agricultural strong income rise helped to create the impression that the rural population had enough economic buoyancy to bear a downfall in their agricultural income generating capacity. Thirdly, the importance and profitability of the agricultural sector had also waned much for the local authorities. With their financial interest somewhere else, it could be expected that they would not oppose any of these changes. A combination of all the mentioned factors is most likely the basis upon which the decision was taken by the leadership.

The remaining measures that were taken in 1987 were interest free cash advances and tied sales of high grade chemical fertiliser and diesel oil at low prices. These had to be implemented by the local government, but were often only partly carried out or not at all. Many local officials diverted their local budget funds designated for agriculture towards the township and village enterprise sector. The most explicit manifestation of local non-co-

operation was the issuance of (illegal) IOUs to the farmers instead of cash payments, causing a severe damage in the farmers' confidence in the state (this issue is turned to in more detail in the next chapter).

The objective of this period's reforms, a quick rise in grain and cotton output, was not attained. It took until 1990 before the grain and cotton output started to raise to acceptable levels (World Bank, 1992a, p.247). The measures taken during the period of 1987 - 1991 changed the direction of the agricultural reform process completely. The results of this backtracking were aggravated by the fact that they affected the poorer provinces, which were mainly agricultural, even more than their richer coastal counter parts. (see Table D).

5.3 *The road to Tiananmen Square*

By far the most dynamic sector of the mid eighties was the rural industry, and in particular the township and village enterprise sector. The years 1985 - 1988 had shown a tremendous rise in the establishment of new rural enterprises. In the late 1980s, over 18 million township and village enterprises had been established and provided employment for over 90 million people, some 17 % of the national working force (CSY 1992, p. 358). The gross value of the collective industrial output had risen from 25% of the total industrial output in 1982, to 30% in 1984, to 34.5% in 1987²⁸.

²⁸ Around 75 per cent of this figure was produced by the township and village collective industry (Ody, 1992, p.xi).

Contrary to what the leadership had hoped to accomplish, the 1986 contract reforms in the state owned enterprises did not lead to a more balanced budget approach in this sector. The relationships with the banks, for one, remained the same as before. The lack of financial discipline and continuation of open credit lines kept the state owned enterprises in its investment craze. In 1988, fixed asset investment grew in the state owned enterprise sector by 20%, in the rural collective owned industries with 25%, in the urban individual industries by 56% and in the urban collective industries by 41% (Table 13).²⁹ This investment demand, growth in output and wages (24% in 1988), in combination with the build-up inflationary pressures from the previous two years, led to a jump in inflation from 7.3% in 1987 to 18.5% in 1988 (see Table B).

Table B - Inflation and economic growth rates (percentages)

Year	Money Supply(1)	Inflation (2)	Total Investment in Fixed Assets (3)	Wage State Owned Units (4)	National Income (5)
1984	42.4 %	2.8%	n/a	17.1 %	19
1985	17.1	8.8	n/a	21.6	24
1986	29.3	6.0	n/a	21.0	12
1987	24.2	7.3	21%	13.3	18
1988	21.0	18.5	23	23.8	26
1989	18.4	17.8	-8	13.5	12
1990	28.9	2.1	8	13.4	12
1991	26.7	2.9	24	11.7	25
1992	30.8	5.4	43	n/a	23
1993	23.6	13.2	51	n/a	25
1994	56	21.7	35	41.34 (8)	23
1995	M2= 34.4 (6)	21.3 (7)	n/a	n/a	n/a

1. 1984 - 1989 - M3 as in Bowles and White, 1993, p. 103
1990 - 1995 - M2 as in Economist Intelligence Unit, 1996, p. 44
2. 1984 - 1989 - inflation as in Bowles and White, 1993, p. 99.
1990 - 1994 - inflation = overall retail prices,
Economist Intelligence Unit, 1996, p. 44.
3. Table 13B

4. State Owned Unit. CSY 1992, p. 101
5. Table 2
6. FEER, 1 June 1995. Figure relates to June 1994-June 1995
7. FEER, 1 June 1995. Figure related to March 1994 to March 1995
8. Oct. Oct. - Nov.30 FT

²⁹ Over 60% of the total sum of investments remained in the SOE sector.

In September of 1988 to fight the inflation, the leadership adopted a macro economic austerity program. Measures that were taken included the curbing of money and credit growth, cutting of public investment, postponing previously contemplated price increases, and encouraging household savings through interest indexation on deposits. The credit squeeze was implemented largely through quantitative ceilings on bank lending (Ody, 1992, p.29).

The local authorities, however, did not react enthusiastically to this austerity program. The rural enterprise success and the new fiscal contract system had changed their situation drastically. Financially, it had become attractive for the local governments to collaborate with rural enterprises. The taxes on the rural enterprises together with remittances of post-tax profits from the collectively owned enterprises had already taken over the dominant position in the overall finance of the lower levels of government (Byrd and Gelb, 1992, p.14). Consequently, the local authorities had been providing their sector with their 'services', and often had organised or paid for most of the necessary investment finances. After having made these material and immaterial investments, the local governments were not particularly keen on implementing any arrangements that would bankrupt 'their' industries. The actual implementation of the proposed austerity measures in their jurisdiction would certainly cause a downfall in the profitability of the rural enterprises and, as such a downfall in local government revenue. They let the firms, in many cases, mitigate the effects of the squeeze on bank lending by locating alternative sources of finance: borrowing from their employees, private lenders or rural credit co-operations.

Thus, despite its efforts, the leadership did not have much success in decreasing the inflation which remained at 17%. Bowles and White comment that “[T]he situation had been allowed to get to this point because a consensus for controlling excess demand had not emerged and the central government was unwilling to move decisively, prior to late 1988, to limit its claims or those of other agents on resources.” (1993, p. 110). But by now, the discontent among the urban population started to rise. A second source of discontentment came from the increasing awareness of corruptive practices within the bureaucratic system. The reforms had provided the local authorities with the possibility of fulfilling a dual role. They were often both the rural enterprise’s (co-)owner /manager as well as its fiscal and controlling authority. This had created a semi-legal way for the bureaucrats to enrich themselves. Corruption was just a small step away. The central government responded to the discontentment by launching a campaign against the occurrence of arbitrary fees and levies by local community organisations and state agencies on the rural enterprises (Schädler, 1992, p.163). The problem of the dual role of the bureaucrat, however, was not addressed.

In April 1989, the heightened tensions among the urban population finally led to a rise of student protests in Beijing and followed suit in many other Chinese cities. Specially disturbing for the leadership were the demands for political reforms. The leadership finally decided on using force to clamp down on the protests when after more than four weeks of continuous demonstrations, the political situation had become too threatening for them (Joffe, 1992, p. 22). Decisive factors were the continued breakdown of talks between the students and the leadership; the joining of the urban workers in the student protests; the growing protest in other cities; and on top, the inability of the leadership because of the

demonstrations to provide the Soviet president Gorbachov a proper guest welcome. On June 4 1989, tanks arrived on Beijing's Tiananmen Square where demonstrators had been camping and protesting for several weeks. The extreme use of force used in Beijing and other Chinese cities, marked the dashing of any hopes on political democratisation and underlined the leadership's determination to continue its authoritarian rule.

The immediate effects on the economic reform process as well as on political balance within the leadership were extensive. Firstly, it led to a weakening of the reform-minded politicians and a re-surge of conservative powers. Translated into the economy, this shift meant a continuation of the austerity program and a slow-down of the reform process. It took until 1991 before the austerity program was halted. Secondly, due to the employment of the military, this group gained additional bargaining powers. Especially in the following period, this translated itself in the military's heightened involvement in the civilian industry.

On the whole, the austerity program caused a decline in the growth figure of industrial gross output, inflation, investment and wages. Gross Industrial Output growth went down from 21 % in 1988, to 9 % (1989), and to 8 % (1990), after which it picked up again in 1991 to 15 % (Table 3). The austerity program also brought about a good amount of rural enterprise closures. Ody (1992, p.31) reports figures from different sources that run from 3 million closures (by the Ministry of Agriculture, January 1990) to 700.000 (Nanjing Business School, 1991), down to 195.000 (Ministry of Agriculture, December 1989). Heightened competitive pressures, phasing out of tax exemption rules, increasing effective tax rates, energy and transport shortages, forced greater reliance on inputs against market prices, and the continuation of the preferential treatment of the state owned enterprises sector

appeared to have been the main factors causing the profitability decline and closures in the rural industries.

In spite of these negative factors, for the rural and urban industries there were actually a few positive consequences connected to the austerity program. In combination with the stricter credit rules the banks put upon their loans, the aforementioned factors created a relatively hard budget constraint. The development of this tougher budget constraint in itself was a positive result. It enhanced a stronger financial discipline and a higher efficiency drive among the collective and individual enterprises. It also provided the rural and urban industries a considerable time and learning advantage over the state owned enterprises if this sector also would be put under a harder budget constraint.

Another advantage over the state owned enterprises and positive for the financial discipline was the more flexible wage and employment system. The majority of the enterprises, around 92 %, used piece rates to set the wages and employees were made redundant when the economic situation necessitated it. Furthermore, the enterprises did not supply any social benefits such as housing and medical care. The advantage for the enterprise was not only lower costs, but also higher efficiency. This could be expected because the enterprise management only needed to concentrate on the enterprise production performance. The main differences in the operation of the collective industries and state owned enterprise sector is shown in table C.

Table C - Comparison of economic performance between the SOEs and the Township and Village enterprises (1978 - 1991)		
	Township and village enterprises	State owned enterprises
Real wages (1)	beneath SOE	above collective
Wage increase 1986-1988 (1)	36.6 %	39 %
Wages	piece rate	nominal wages + bonus
Social side benefits	no	yes
Share in industrial output 1985 (2)	14.6 %	64.9 %
Share in industrial output 1991 (2)	2.6 %	52.8 %
Employment 1978 (3)	28,27 million	89,9 million
Employment 1991 (3)	96,09 million	106,64 million
Redundancy	easy	almost impossible
Used input prices	market	planned
Charged output prices	market	planned, partly market
Nominal capital stock growth 1978-1988 (1)	21 %	8.7 %
Share in export, 1985 (1)	4.4 %	
Share in export, 1990 (1)	21 %	
Ownership	Community/ local authorities	large SOE: central government medium and small: local government
Location	Majority in Coastal areas	Majority in Central and Western Provinces
Tax	Largely retained by local authorities	Collected by local authorities, large enterprises profit and taxes were fully remitted to the central government.
Credit	More difficult to become through the State Banking sector	All losses supported by the local or central government.

Sources:

(1) Ody, 1992, p.9,p.15

(2) World Bank, 1992

(3) Statistical Yearbook of China issues 1978 - 1991

5.4 Economic bottlenecks: infrastructure and energy

Two problems that had already hampered the economic reform process during the previous reform periods became most pressing at the end of the eighties and beginning of the nineties: the transport/ infrastructure and energy bottle necks (Harrold & Lall, 1993, p. 19). Not only did they exert influence on the inflation, but on a more micro level, affected the rise of regional disparities. Also, the manner in which the leadership tried to interfere in the provinces' advancements in the alleviation of the bottlenecks displeased some of the provinces. The importance of these two factors in the analysis of regional growth patterns requires its inclusion in this chapter.

China's **transport sector** is small by international standards. The density of both road and rail transport networks in relation to population and arable land is among the smallest in the world.³⁰ The smallness of these sectors has been the result of historic under-investment. Before 1978, Mao advocated regional economic self-sufficiency and forbid inter-regional trade. During those days, the local rural community members' only obligation concerning the local infrastructure was to take care of its maintenance (e.g. roads, dikes and irrigation system). This local maintenance was either paid by the local community funds or it was unpaid and performed by its members during the off-farming season. Strangely enough, during Deng Xiaoping's reform era the 'under-investment policy' in infrastructure even worsened. Annual investments in transport infrastructure represented only about 1.4 % of

³⁰ Except the former Soviet Union that had a smaller railway system relative to area, but relative to the population it was much bigger than China's.

GNP compared to about 2 - 3% for countries such as Korea, India and Brazil (World Bank, 1992, p. 133-141). In addition, the introduction of the household responsibility system broke up the local infrastructure's maintenance system. This was not replaced by a new institutional framework. Consequently, since 1984 rural and urban infrastructure has been very neglected.³¹

Instead of putting effort in expanding the overall transport capacity and infrastructure, the government mainly tried to satisfy its fast rising transport demand by raising the freight intensity on the existing railway and road network.³² Between 1980-1993, the total transport freight performance more than doubled from 1,153 to 3,050 tonkilometers³³. Due to the dire state of the roads, road transport only took up 13% of this figure. Waterways' transport provided 45% (2/3 ocean and shore, and 1/3 inland) and the railways almost 40% (Radstaak, 1995, p.14). Although the transport sectors road, air and inland waterways, grew between the 10% and 20% annually, they were historically too small to make much of an impact on the total transport capacity. Not surprisingly China's freight intensity became the highest in the world. Freight intensity measured in tonnes per unit of GNP would be 10 times the level of India and Brazil, while its tonkilometer of traffic per unit of GNP is three time higher (FT, 6-12- 94).

³¹ Another direct result from this neglect has been a constant rise in 'natural' disasters like flooding. Over the years thousands of people have died, and hundreds of thousands have become homeless. In July and August of 1994 flooding produce a death toll of nearly 3000. The Far Eastern Economic Review reported that the primary damage amounted to nearly US\$ 59 billion, without even reckoning the knock-on effect of lost production and delays caused by damaged infrastructure. In addition, the moving of relief supplies to the disaster stricken areas overtaxed the already strained infrastructure (FEER, 27 Oct 94).

³² Radstaak reported that during the eighties the average additional railtrack development was a mere 350 km. Only 17% of the railways have been electrified (1995, p. 107)

³³ Ton/kilometer per unit of GNP is the average distance in kilometers that the different intermediate goods, natural resources etc. need to be transported to produce 10,000 kg GNP.

Also the distribution of the transport among the different economic sectors reflects how pressing the constraint for further economic development really became. The transport of coal took up around 40% of the freight carried on the railways. Because the transport by rail was in the hands of the state and the leadership put its transport priorities on coal, steel, minerals and grain, there was not much room left for other goods. The transport of light industrial products and other agricultural goods is mainly left to the road and waterways. But because only 89% of the roads were hardened and not even 1% of the roads could be designated as highways (by international standards), the prospects of a fast expansion in transport capacity for these products was low. It came as no surprise that the average transportation distance in road transportation was only 48 kilometres (Radstaak, 1995, p. 104). In addition, the carrying capacity of the trucks was very low in comparison to the fuel use. They operate highly inefficient, which made road transportation expensive (Imran & Barnes, 1990, p.8).

This shortage in transport facilities gravely undermined the profitability of product specialisation, especially for the rural sector of the inland provinces. These regions were the least populated and accessible, which drastically shrunk the profitability margin on most potential produce. This makes the fact that in 1991 only 7% of the rural industrial output was produced in the Western regions a lot better to understand.

Since the start of the reform process, the **energy sector** was never able to catch up with the economic growth. The ratio between the designed installed capacity and the power consumption of power driven industrial equipment was 1 : 2.4. In 1991, it was estimated that in the south-eastern provinces alone there would be a shortage of no less than a third. As a consequence, there were frequent power black-outs, quotas for new connections, and

industrial equipment that was unable to run at full capacity (Asian Development Bank, 1992, p.4).

The energy expansion problem³⁴ mainly came as a result of the industry's dependency on coal. Between 1992 - 1994 it supplied 75% of China's energy consumption. Oil only provided 18 %, hydra power 5% and gas 2%³⁵ (Adams, 1994, p. 221). Firstly, there was the transport and location problem. Even if the Chinese had been able to extract enough coal, there would not have been enough transport capacity to convey it. Nearly three-quarters of proven coal reserves lie in north China (Shanxi and Northern Shaanxi). The main areas of power consumption, however, are at the coast in the east and south east of the country. In thirteen coastal provinces, energy production accounts for only 13 % of the national total, while they consumed 65 % (Cannon & Jenkins, 1990, p.180). Secondly, the extraction of coal has been very inefficient. Production growth has been hampered by lack of adequate modern mining equipment and expertise. While tunnelling, extraction, loading and conveying are more than 95 % mechanised in any western country, the degree of mechanisation in China, even in the largest and the most modernised mines, was less than 50 % in 1990 (Economic Intelligent Unit, 1991, p.34).

³⁴ In the rural areas, another pressing energy problem developed which in time might influence the economic reform process. Non-commercial energy, including firewood, dung and straw stalks, is the main source of energy used in the household consumption (Asian Development Bank, 1992, p.240). The provision of these resources is not sufficient. In 1989, about half a billion Chinese lacked enough fuel to cook three daily meals for three to six months of the year. Due to the population growth and because the current household energy resources do not provide any output growth prospects, this shortage has been rising. Moreover, the rate of wood depletion is much faster than the new plantation rate.

³⁵ Electricity, which can be generated either by coal or hydropower, provides only 5 per cent of the energy consumption. Compared to India (28%) and Brazil (41%), this figure is far too low (Imran & Barnes, 1990).

5.5 *The emergence of regionalisation*

Having gone over the economic bottle necks, different economic reform measures that were taken during 1987 - 1991 and the effect they had on specific interest groups, I have to start integrating the cumulative effect some of these measures had on the power position of the different regions as a whole. As time went by, the reforms had also started to produce a redistributive process across the provinces. The effects on the different power groups' position generated by the reform process gradually started to diverge over the provinces. It became increasingly complex to analyse the common denominator within the same group in the different regions, and thus their collective reaction to individual reform measures. It is exactly this fact that was bearing the seed of power loss for the leadership.

Historically, Mao had pursued an industrial development policy that had resulted in the development of many state owned enterprises in the Chinese hinterland. In itself, this policy had contributed to the opening up of many remote areas and it had enabled less privileged areas to benefit from the economic growth which happened after the Communist take-over in 1949. But, as mentioned in section 5.3.2, by 1978 most of these state owned enterprises were underperforming. This problem was still not resolved by 1991. With the fast development of the collective enterprises one would think that at least part of the reason why bankrupt state owned enterprises were not being closed, like lack of financial local resources and employment opportunities, were increasingly being mitigated. But, this sector did not develop to the same extent in all provinces. Unlike the Coastal and some Central provinces, the

Western provinces were not able to start much of a township and village industry (see Table + table 14

E). The industry the Western provinces promoted most heavily was the private sector.

In the first years of the reform process, the leadership had recognised the private business sector as a complement to the public economy, but it had kept it under strict employment ceilings. The companies had been allowed to employ up to eight people only. Because of the previous anti-capitalist period under Mao on the one hand, and a lack of a smooth free market mechanism on the other, this sector only developed slowly. During those first years, not only the bureaucrats shrank from stimulating or participating in private business, but so did the rest of the population. For some time, the general confidence in the continuation of the current private business policy remained very low. It did not pay to invest money in a business, when the chances of future confiscation by the state had not been ruled out. Consequently, by 1985 private business still only produced 1.8 % of the gross national output.

The situation started to change after 1986. The credibility of the reform process and its continuation had been rising substantially as a result of the township and village industry take-off and the new fiscal reforms. The effect was a growth in private business. As mentioned before, the Western provincial governments started to promote the individual and private business, because they had limited community resources and were much more dependent on private investment for economic development growth in their regions. Growth in this sector would provide additional provincial tax revenues. In contrast, the provincial authorities of the richer areas in the East of the country promoted more the township and village collective enterprises among its counties, while at the same time taking active measures to discourage private business. The coastal authorities did not want to miss out on

the potential higher revenues of the collective industry. As they had the money to invest in the township and village collective enterprises, they could pick the fruits of their economic development both via taxes as well as direct revenues.

The direct result of the low investment in the Western and Central's collective and private industries was that the economy in these provinces did not develop as fast as the Coast's, and their production figures increasingly started to lag behind (see Table C). The low investment figure was the consequence of their remoteness, scattered population and lack of financial surpluses held by individuals. At the same time, the preferential treatment most Coastal provinces received with investment funds and special economic zones did not help either.

Although the open-door policy and special economic zones had not generated the leadership much additional revenues, the coastal development remained prominent in its plans during 1987 - 1991. It seemed that the leadership remained convinced that if the coastal provinces would be able to develop in advance, the entire country would benefit. The coastal bias became very explicit when in the Seventh five-year plan (1986-1990), the leadership officially attributed different development objectives to each of the three regions: Coastal (41% of total population), Central (36%) and Western (23%) (see for subdivision Table 14). The strategy implied that virtually the entire coastal area would become an economic development region. The inland provinces had to continue to direct their development at the primary industry, and the Coastal at the processing industry. Unfortunately, the leadership did not rationalise the prices of the primary industry and kept them far below the world market prices. Most consumer prices, on the other hand, were no longer regulated. In other words,

the Western regions were to specialise on the unprofitable primary industries and the Coastal regions were able to set up the high value added and profitable industries.

By 1991, the Coastal provinces' share in the national production had risen to more than 50% of the industrial output. It also received, conform the coastal development strategy, more than 50% of the state investments in fixed assets. In addition, the Special Economic Zone policy had ensued that 90% of the foreign investments had gone to these Coastal regions, with Guangdong province (at the border of Hong Kong) getting the lion's share of 65%. Less than 5% of the foreign investments went to the Central provinces, and less than 3 % went to the West (UNIDO, 1992, p.72). Western regions still only produced 12 % of the national industrial production. On the other hand, the Coastal regions, with only twice as many people (49% of total population), produced 64%. During this period, the cumulative effect of the growing regional disparities slowly started to influence the power position of the leadership. Nevertheless, it would take another year until the political costs really started to mount (explained in the next chapter).

5.6 *Changing constraints and the balance of power*

In the years leading towards the Tiananmen incident, the leadership was politically incapable of averting the inflation danger. Only the sector where the political costs were the lowest (agriculture) was brought back under central control through adjoining price measures (Assumption 3). The state industries kept operating under a soft budget constraint, declining profitability and growing investments. The fiscal system did not deliver sufficient revenues

to close the budget deficit, which was largely solved by the monetary printing press (11% of National Income in 1988 and 6% in 1989) (Assumption 6). When the urban population finally exercised their power in the form of the demonstrations during May and June 1989 to show their discontent with the mounting corruption and inflation, the leadership had to resort to force to restore order.

Momentarily the reform process was slowed down. The mere fact that it started again so soon in 1991, in my opinion, reflects the newly gained financial interest within the most important interest groups and the urban population in a continuation of the process (Assumption 4). This gave the leadership its legitimacy and strength to continue to implement economic reform without political reforms.

The result of the reform measures on the playing field were mostly on the technical and resource constraint. The share of the collective and private industry in the total industrial output was moving towards 50%. This meant that at least 50% of the industrial market was conducted on the free markets, and that the planned part of the economy annually was being eroded.

The resource constraint did not weaken during this reform period. Although budget revenues increased, the government expenditure rose even faster. Despite the fact that the economy was growing rapidly, a lot of tax remained at the local level and outside the government budget. At the same time, the budget expenditure items, the urban subsidies and state enterprises, remained their high levels and in addition the new budget item 'repayment of loans' was rapidly rising. By 1991, the budget deficit had nearly been doubled since 1986 and up to 1991 more than 3/4 of the budget deficit remained unfinanced (83% in 1988, 74% in 1989, 78% in 1990, and 93% in 1991: Table 5,6).

Ultimately the reform process started to cause greater disturbances in the balance of power:

- What came to surface was that once the bureaucracy had gained their financial interest in the collective industries, they did not want to part from them. When the leadership demanded the bureaucracy to lower investments in this industry and curtail banking credit, the bureaucracy seemed to put the local business interests before the national interests although they were supposed to be the representatives of the Chinese state. The decentralisation of bureaucratic power led to an increasing divergence between the interests of the leadership and its lower level bureaucrats (Assumption 10).
- The state owned enterprise sector had not lost much of its power because of its worsening (external) financial situation in combination with the leadership's lack of alternative financial resources. (One could argue that this gained them more political leverage).
- The leadership was harshly reminded of its dependence on the military via the Tiananmen incident. According to Joffe, it is most probable that the military did not want to get involved much and the costs seemed to have been high: "... an ugly stain on its hitherto fine record; alienation from at least part of the population; a marked slowdown of military modernisation; and a return to the primacy of politics at the expense of professionalism." (1992, p. 32).³⁶ Standing to loose so much, it therefore seemed more than likely that the military, as said earlier on, must have received some sort of deal from the leadership either on political power (e.g. heightened independence) or financial resources. Another reason behind this expected rise in military spending was the Gulf War. This war brought

³⁶ For a comprehensive account of the role of the military during the Tianamen incident see several articles in: *China's military - The PLA in 1990/1991*, 1992, edited by: R.H. Yang, Westview Boulder Press, Boulder

another blow to the Chinese military. The arms they had sold to the Iraqis did not perform adequately. The result of this was not only an expected slump in foreign demand for Chinese arms, but also a realisation within both the leadership and the military that China had to modernise its forces and armament.

- The urban population's income and welfare had been steadily rising. In addition, there had been an increasing influx of foreign cultures and ideas. These two factors seem to have provoked a more emancipated attitude in the cities. The Tianamen incident of 1989 and consequent crackdown on organised student and workers groups underlined the hegemony of the leadership and China's autocratic foundations (Assumption 2).
- The decline in profitability of the agricultural sector, especially compared with the rural industries, lessened the importance of the rural population that were dependent on the agricultural sector even further. In practise this affected the Western provinces most (Assumption 3).

Table D - Comparison of regional economic performance in 1985 - 1991

Regions	Percentage of total population	Value of industrial output per capita, yuan	Percentage of total industrial production	Value of agricultural output per capita, yuan	Percentage of total agricultural production	Total investment in fixed assets per capita, yuan
Coastal 1985	41.3 % -	1383	61.2 %	360	42.8 %	296
1991		3776	64 %	817	48 %	
Central 1985	35.7 % -	694	26.5 %	357	36.6 %	201
1991		1676	24 %	645	33 %	
Western 1985	23.0 % -	498	12.3 %	311	20.6 %	165
1991		1258	12 %	606	20 %	

source: Cannon and Jenkins, 1990, p.41; Adaptation of China Statistical Yearbook 1992, p 79, 368

Table E - Comparison of regional disparities in industrial production 1991

Region	Coastal	Central	Western
Percentage of total population	42 %	36 %	23 %
Percentage of total gross output value of industrial production	64 %	24 %	12 %
Regional share per sector:			
State owned enterprise			
Collectively owned enterprise	55 %	30 %	15 %
Individually owned enterprise	73 %	19 %	7,6 %
	57 %	31 %	12,5%
Value of industrial production per capita (yuan)	3776	1676	1258
Share per sector:			
State owned enterprise	45 %	64 %	70 %
Collectively owned enterprise	41 %	28 %	23 %
Individually owned enterprise	5 %	6 %	6 %
Rural industrial output value per capita	1286 Y	370 Y	231 Y
Percentage of rural industrial output	74.2 %	18.5 %	7.3 %
Percentage investments in fixed assets (1)	58 %	27 %	19 %
Percentage in foreign investments (1)	92 %	5 %	3 %

Source: (1) Unido, 1992, pp.72; Adaptation of China Statistical Yearbook 1992.

6 The end of Deng Xiaoping's reform era (1992 - 1995)

6.1 Introduction

In 1992, both China and the rest of the world gradually started to recover from the shock that the Tianamen incident and its aftermath had created. It had gravely undermined the credibility of both the government as well as the continuation of the reform process. But three years down the road without any other grave disruptions along the way, the economic development regained its former dynamics. The 'socialist market economy' was officially embraced by the Party. The township and village enterprises, and by now also the private industry, expanded their operations both domestically as well as internationally. The first state owned enterprises raised money via the Hong Kong and New York stock exchanges. Foreigners poured ever increasing foreign direct investment funds into China.

It was also the time that the first Mercedes were to be spotted driving down some Chinese streets, that MacDonalds and Pizza Hut opened their doors and that one could buy the soft drink Sprite and Fanta on virtually every street corner. Likewise it was a time that brought an increasing amount of peasant riots, beggars, unemployed urban and rural youths, and corrupt officials. Economic prosperity had not come to everyone.

By 1992, the leadership's playing field had entirely changed from its 1978 dimensions. The most crucial difference came from the balance of power. When in the previous reform

periods the leadership had to pay most attention to bilateral relations with the different interest groups, during 1992 - 1995 a different dimension became significant in the power game: provinces versus leadership.

Almost no academic research has yet been published on the years between 1993 and June 1995, but its implications are of such importance and of influence on the continuation of the reform process, as well as on the conclusions of this thesis, that I have decided to include this period nevertheless. The material I use for this section are drawn from over 300 newspaper articles and Chinese broadcast texts³⁷. This chapter will try to infer the final years of Deng's reform era.

6.2 The leadership contest

Due to his age (born in 1904), Deng Xiaoping had been trying to step out of the lime light for most of the eighties. But his first chosen successor Hu Yaobang was made to resign after major internal social instability had surged in 1986. Zhao Zhiyang, the next hand-picked successor, met the same fate a couple of years later with the Tianamen incident in 1989. As the split in the leadership was still prevalent, in practice these incidents had meant that Deng was forced to keep a strong influence on the leadership and the reform process. Unfortunately for the leadership's decisiveness, he was not able to reconcile the two opposing factions. As

³⁷ Papers and weekly journals used are the Financial Times, the NRC Handelsblad, the Guardian, the International Herald Tribune, South China Morning Post, China Daily, the Far Eastern Economic Review and the Economist. The broadcasts from Chinese or Hong Kong newspapers come from the BBC SWB publications.

the power of the factions often changed, so did the reform process: the sequencing of the reform measures, their timing and the many reform reversals. The reform process was often (re-) directed according to the preference of the faction which had the upper hand.

At the beginning of the nineties the need for the appointment of a third successor became more urgent as Deng was approaching his nineties. Not only did his faction in the leadership need a designated helmsman, but the Party as a whole needed a new 'face', in other words an ultimate leader. His faltering health also meant that his influence on the succession was rapidly declining. In addition to Deng's pre-eminent departure, the leadership's political stability was shaken by the death of three other political veterans who died shortly after one another. The different alliances started to put increasing efforts into trying to gain the upper hand in the leadership succession.

By 1995, the political infighting for the top job had become an important international news item. Not only was the death of Deng Xiaoping expected, but it was also considered to have a major influence on the smoothness of Hong Kong's transition back into Chinese sovereignty from Great Britain in 1997, and the issue of Taiwan's independence. Although Jiang Zemin had been officially appointed as the paramount leader in 1994, most commentators stated that they doubted very much that this leadership's pecking order was definite³⁸. It was clear that a power struggle was developing itself in the leadership. Jiang Zemin's main contenders seem to be Li Peng, Zhu Rongji and Qiao Shi. These latter men were more associated with Deng Xiaoping's reform beliefs of a more progressive open economy, which, among other things, more or less held that corruption was the price to be paid for economic development.

³⁸ e.g. IHT, 11-5-95, p. 6; FT, 1-5-95; NRC, 25-3-95; FEER, 2-3-95, p.14-15; Time, 23-1-95, p.22-24.

The power play seemed to come out into the open with Jiang Zemin ordering not only several protégés of Deng Xiaoping, but also several member of his direct family to be put under investigation on corruption charges (youngest son and niece)³⁹. An act which he never would have performed if Deng Xiaoping still had supreme powers. Jiang Zemin had become the driving force behind the national corruption campaign that was to address the rise in bureaucratic corruption. However, this campaign could easily be used to purge bureaucratic adversaries. It was noted that such moves were weakening the triumvirate clan, which would enable Jiang to take over power after Deng's death. Many expected a power struggle to erupt as soon as Deng Xiaoping would pass away.

What this seemed to imply was that the leadership between 1992 and 1995 showed a deterioration of its inner stability. Although since the beginning of the reform process the leadership had instigated structural reforms in virtually all economic sectors, had changed many macro policies and had even altered the goal of development towards a socialist market economy, it had not adapted its own structure. It can be assumed that this political stagnation must have considerably affected the outward strength of the leadership, and thereby ultimately the balance of power.

³⁹ In section. 4.6.2 it was already mentioned that the corruption campaign had reached the Beijing capital. One of the vice mayor's hereupon committed suicide, the other was arrested along with the mayor and the Party Secretary Chen Xitong.

6.3 A socialist market economy

The economic austerity program that had been started in 1988 was formally put to an end in 1992. Much to the delight of the investment hungry industries, a relaxation of the monetary and credit policy was announced. However, the most important and influential events of that year were Deng Xiaoping's trip to Southern China and the ratification by the 14th Party Congress of China's development towards a "socialist market" economy. This latter measure meant that finally the Party was no longer supposed to play the primary resource allocation role, but the markets were to take over (Harrold & Lall, 1993, p.xiii). The ratification of this reform proposal was seen as an important signal to both domestic and foreign investors that the Party was earnest in its intentions to pursue further liberalisations in and the marketisation of the economy. Deng Xiaoping's trip to Southern China in the Spring of 1992 was seen by Western China watchers as a clear message to the progressive reformers that he still supported a continuation of economic reforms, and that Shanghai was to receive the green light to advance in collective and private industries just like its neighbouring Guangdong province. Since the Tiananmen incident the conservative faction within the leadership had gained the upperhand, but Deng's trip reflected a change towards the progressive faction.

Concerning the state owned enterprises, renewed reforms were proposed that were to make them more autonomous and fully responsible for their own profits and losses. It was especially the expansion of an experiment with share holding or limited liability companies that gave many people in the Western world the hope that China would accelerate towards a free market economy. By the end of 1992, there was a total of 3,700 shareholding companies

of which the vast majority was wholly owned by staff and workers. Largely due to the fact that the stockmarkets in Shanghai and Shenzhen were still in their infancy state, just 2% of these shareholding companies were subsequently listed. Despite these progressive market reforms, the government, however, did not put forward any intention that indicated a complete turn away from an economy dominated by state or semi state ownership. Privatisation of state owned enterprises was still restricted to the sale or leasing of small state owned enterprises only.

At first sight the economic performance figures of 1992 were very impressive. A National Income growth rate of almost 23%, with low inflation (5.4%) and a reduced (but still substantial) budget deficit (see Table B). By now, also 90 % of the price regulations had been abolished. Gross industrial investments grew with 42%. However, underneath these positive figures some other more disturbing trends were developing concerning the state sector and the stability of the economy. According to a World Bank report of mid 1993, the investment demand was one of the most serious issues for the government at that time. "The strongest force for growth has been fixed investment demand, currently rising by over 30 % in real terms. This led to price increases of close to 40 % per annum for raw materials in the last year, made possible by the accelerated price reforms in this area, as well as declining stocks. A further indication is to be found in the "bubble" sectors of real estate and securities....excess demand in the bottleneck sectors of transport and electricity." (Harrold & Lall, 1993, p. xii).

Despite its declined profitability, the state owned enterprise sector remained the largest investor with more than 2/3 of the total investment figure (Graph 12 A). At the same time, its share in the gross output value of industry decreased further from 52.9% in 1991 to 48.1% in

1992 (Graph 1B). State enterprise and price subsidies topped to 88,360 million yuan, almost 22.5% of the government revenue (Table 5). Consequently, scarce resources were taken up by an industry that only benefited 18% of the population. On the monetary side, the broad money base had increased since 1990 with around 30% annually. By the end of 1992, this combination of continued strong demand, scarcity of resources and high money supply growth led the inflation to rise again and the economy showed signs that it was about to overheat.

Inflation did rise in 1993, and it appeared more than ever before that the leadership was in a stalemate with the state owned industry sector. Consequently, the state enterprises were able to continue their investment drive and remained recipients of large direct and indirect subsidies. This enabled them to even enlarge their share in the total industrial investment figure to 72% in 1994, while their share in the total industrial output declined further to 45%. According to the China Daily (5 May '95, p.4) the low efficiency of the state enterprises had turned the majority of these investments into wasted money. It stated that by the end of 1994, 50% of that year's investments had resulted in nothing but huge inventories and that the net value of uncollected receivable accounts of enterprises stood at 400 bn yuan (\$48 bn)⁴⁰. The state owned enterprises' losses for 1994 were again 7.8% higher up to 33,6 bn yuan (SCMP, 8 May 95).

After 17 years of reform in the state enterprise sector, Broadman comes to the conclusion in a World Bank report (1995, p.xii) that "...many - but by no means all - SOEs continue to have serious problems. In part, these problems are structural: (a) excessive and

⁴⁰ The Economist reports in its China Survey, 18 March 1995, an even more astounding figure: "...unpaid debts among Chinese companies rose 74% last year to 600 bn yuan (\$70 bn), equivalent to about 30% of industrial output."

rigid patterns of corporate integration ...; (b) use of 'obsolete and often inappropriate technology; (c) virtual absence of multiplan economies of scale, especially across regions; (d) excessive investment in heavy industry at the expense of higher value-added activities, including services. In addition, SOEs' performance suffers because of the "social burdens"⁴¹ they carry."

During the period 1992 - 1995, most state owned enterprise reforms did seem to portray a firmer step into the direction of a complete marketisation. But looking deeper into the matter one could see that the problems as just described were still prevalent and three major constraints of the state sector had not been adequately addressed: the soft budget constraint, the miscellanies of state owned enterprise production goals and the widespread bureaucratic interference in the market place as well as in the internal enterprise operations.

The continuation of the soft budget constraint was caused by the lack of progress on the capital markets. There was a continued use of inter industry debt and of loans from non-bank financial institutions; an absence of legal action measures that banks could take in case of default; and a continued bailing out by the government of bankrupt enterprises. Secondly, no sufficient moves were made to take over some of the state owned enterprise's responsibilities and establish a social security system, free housing market, national health service or education system. It was still largely left to the state owned enterprises to provide these goods to the urban population. Thirdly, not much progress had been made with the introduction of a

⁴¹ In his 1995 report on the state enterprise sector, Broadman summons the "social burdens" that the enterprises still have. Basically,, there has not been a great shift away from 1978: "...providing to workers lifetime employment, resulting in an average SOE redundant labor force of 30 to 40 percent; and...providing an array of social services such as housing, education, hospitals, social security, food services and fuel and retail outlets. On average, SOEs provide housing for 93 percent of their employees and 51 percent of all urban residents....It has been estimated that the social services amount to about 6 percent of a typical urban SOE's total costs and 40 percent of its wage bill" (1995, p. 9)

free labour and technology market; regular policy changes on matters like prices, export/import, finances, tax, shareholding etc. kept the enterprises from improving both its cost efficiency and profitability, and created an uncertain market environment.

By 1995, the leadership still appeared to find itself in the same catch 22 situation it had been into in 1978: it did not want to take actions that could lead to urban uprisings and political rambling in the top of the Party and government, nor did it want the continued drain on its limited financial resources by bankrupt state enterprises. However, the difference between 1978 and 1995 became the surrounding factors of the economy. Most importantly, two other industrial sectors (collective and individual enterprises) now provided potential alternative employment and tax resources. They were growing fast and already were producing half of the industrial gross output. Secondly, the economy was overheating, and the inflationary threat of a continued state owned enterprises' soft budget constraint contributed too much to this. Thirdly, the importance of the state sector for the government revenues had declined. Fourthly, within the balance of power, the coastal provinces had gained much political clout. Increasing disgruntled sounds on the lack of progress in state enterprise reform could be heard from these provinces.

Consequently, although the structure of the state owned enterprise sector had not changed drastically, the changed environment in which it operated did create more pressure than ever for real structural reforms. In tandem, the power position of the state owned enterprise management and ministries had slowly started to decrease relative to the rise of the new collective and individual industries. An agenda for the establishment of a socialist market economic structure which was approved in November 1993, might provide the actual means towards establishing these real structural reforms in the state owned enterprise sector

(FT, 4-11-94). The most important issues proposed were the creation of an enterprise system based on the principle of corporatization and providing full separation of the state's exercise of ownership rights from the enterprise's exercise of legal person property rights; the authorisation of the central bank's independence; the creation of an expanded capital market, banking and finance system, including commercial banking; the establishment of a market-oriented legal system (Broadman, 1995, p. 25).

By 1994, inflation was still high at 24.1% (Table B, p...). This fuelled the fear for social unrest among the leadership. To fight the inflation the leadership introduced a new stabilisation program in August 1994, which included strict price controls and credit ceilings (FT, 22 Sept. '94). At the same time, it created a budget deficit for 1995 that was twice as large as in 1994 and announced that it would no longer borrow directly from the People's Bank to finance its budget deficit, nor pursue pure monetary financing. It would solve the budget deficit of 153,7 billion yuan via domestic bond issues and treasury bills. Table 5, however, shows that this resolution was very optimistic as it would mean nearly an eightfolded increase from the 1990 deficit figure that was financed with government bonds and treasury bills. Zheng comments in the Far Eastern Economic Review (30 March 1995, p. 34) that "However, though they are less obvious, the expansionary implications of the budget deficit still exist. Due to nominal interest rate control and borrower's soft budget constraints, the bond financed budget deficit is unlikely to crowd out other sectors' savings and investments. Therefore, the central bank will still be pressured, albeit indirectly, to inject more funds in the economy" (see Table 5).

6.4 Continued growth in the collective sector

The collective enterprise sector's expansion continued during 1992-1994. By 1994 it employed around 120 million people or 20% of the total labour force (SWB, FE/2245 s 2/6, 7 March 95). Annual investments in the urban and rural collective industries grew 94% in 1992, 54% in 1993, 32% in 1994 (Table 12). Their output grew and their share in the national export was 25% in 1994. Also the individual enterprise sector flourished with investment growth figures of 3.4% in 1992, 15.8% in 1993 and 28% in 1994. Together these two sectors were the driving force behind the 'socialist marketisation' of the economy. An important factor in the creation of the drive was the fiscal system.

As explained in the previous chapters, this system had given local authorities the incentive to invest or at least promote the local collective industries as it provided them additional budget revenues outside the control of their bosses or central government. In principle, the effects in terms of investment and production growth were positive accomplishments. However, there were some problems attached to this system which became obtrusive for both the financial situation of the central government as well as to economic growth at the local level. Firstly, the fiscal system had not been able to translate the success of the collective and private industry sectors into sufficient revenues for the central government⁴². The government's real budget deficit remained too high, in 1993 16% of the government expenditure was not covered by revenues and in 1994 10% (Table 6).

⁴² "In 1978, ...fiscal revenues were equivalent to 31% of China's GDP; by 1993 the proportion had fallen to 13%. Over the same period the share of tax revenue going to the central government had dropped from 60% to 40%" (Economist, Survey 18 March 1995, p. 16).

Secondly, it contributed to the occurrence of local protectionism. The bureaucrats were unwilling to reinvest the local revenues anywhere else than in their own area as they otherwise would lose a new taxable resource and forgo local employment opportunities. This protectionist attitude led to investment projects that were not always very efficient. What was considered profitable at the local level did not need to be optimal for the nation as a whole. Another result of this attitude was the rise of regional trade barriers (CD, 6 May 95, p.7). Under the cloak of the infant industry argument (new investment needs to be protected in order to get strong enough to compete under the same conditions with the rest of the market) local authorities restricted inter-regional free trade.

Aware of these problems, the leadership introduced new tax reforms in 1994. Besides the existing local tax offices, a national tax service was set up which from now on would collect all central and shared taxes. The main plank of the system was “ a value added tax imposed at a standard rate of 17%, replacing other turnover taxes. Revenues from VAT are split 75-25% between national and local governments. The tax on corporate profits has been standardised at 33%.” (Ec, 18 March ‘95, p.16). The idea was to bring the share of central government’s tax revenues back to above 50% by 2000, so that the centre would have a stronger control over the provincial budgets and thus their economic policies. But the difficulty of the system, on the one hand, lay with the low pay of the national tax collectors, and on the other hand, most local authorities did not gain anything by participating in the scheme. They would have to surrender more of what they collected. Put in the context of the strong political power that the provincial authorities had been gaining, it has been especially the latter fact which has contributed to the sincere doubt over the actual effects and viability

of this new system⁴³. In 1994, nominal tax revenues rose by 21%, a growth less than the rate of inflation.

The other important factor in the success of the collective industry was the involvement of the bureaucracy in the industry. Over the years the development of business had become the main objective for many bureaucrats. This not only took their attention away from their official public job, but influenced the bureaucrat's objectivity on matters of trade, finance and free markets (as seen in the mentioned local protectionism). This dual role of the bureaucrat was addressed via two ways: an anti corruption campaign and a new business deal. The latter reform meant that at the end of 1992, bureaucrats were given permission to set up businesses while retaining their official ranks (Ec, 17 July 1993, p.58). This would lower the government's administration cost as it no longer would need to pay the bureaucrat's wages, and at the same time take one role away from the bureaucrat. How realistic this reform was is questionable. Official data and other research on the effects of the measure have not yet been published. It is highly unlikely that a bureaucrat-turned-business-man would give up all of his previous privileges and personal contacts.

In tandem, as mentioned earlier in section 6.2, a forceful anti-corruption campaign was started. On several occasions the Party's disciplinary commission formally issued statements on e.g. barring officials from engaging in business on their own account or using their influence to assist relatives and friends and profit from their activities, accepting gifts, money, negotiable securities or credit cards (FT, 26 Aug. 1993). But the campaign did not stay with the publications and media attention only. During 1993, 1994 and 1995 several officials were

⁴³ Many authors have expressed sincere doubt over the true effect and results of this system (e.g. FT, 3-11-94, p.7; FEER, 7-7-94, p. 62; FEER 11-5-95, p. 19)

charged with committing crimes such as embezzlement. Some of them were even executed⁴⁴. In April 1995, the corruption investigations led even into the higher Party and bureaucratic echelons which in turn, besides the mentioned arrest of members of the Deng family, provoked a suicide from one of the two vice mayors of Beijing and the subsequent sacking of the city's Mayor (FT, 10 April & 1 May '95).

Without a doubt corruption was taking place. After analysing the collective and individual industry in combination with the fiscal system, one can understand the bureaucrat's possibilities for self-enrichment. But if one focuses on the overall effect the corruption had on the development of the collective and individual enterprise sector one can argue that so far the corruption did not seem to have hampered its growth too much. Judging by the growth figures of the industries, it is most plausible that the majority of the Chinese bureaucrats so far would *not* have performed predatory extraction⁴⁵ on 'their' local collective or private enterprises. It can be argued that the bureaucrats must have felt secure enough about their own positions and accompanying political and rent-creating powers, as well as the continuation of the growth in the economy to possibly enrich themselves legally or illegally, but that they have abstained from predatory extraction. In itself an important indicator of the bureaucrat's expectations on the future reform process and political stability.

⁴⁴ "China executed seven officials over the weekend, including the mayor of a small town in southern Henan province, as a nationwide corruption drive gathered pace. By September, 5,040 party and government officials, including 20 at department or city level, and at vice-ministerial level, were charged with committing crimes such as embezzlement." (FT, 1 Nov. '93)

"Chinese authorities announced the arrest of 300,000 officials - one fifth of all cadres- in eastern province Anhui on corruption charges. According to Xinhua newsagency, the officials embezzled a total of Rmb 826 million (US \$141 million)." (FEER, 20 Jan 94, p. 15)

"During the last 10 years, courts have prosecuted more than 20,000 cases of local officials faking statistics to impress their superiors or earn more central government funding." (Far Eastern Economic Review, 9 June 1994, p. 73)

⁴⁵ 'Predatory extraction' is the extraction of money out of the enterprise until it is finally bankrupt.

6.5 Setback of the agricultural sector

By 1992, what had started out as the most successful reform sector was profitwise the least successful sector. During 1992 - 1994 the situation in agriculture deteriorated further. Although some agricultural products did show healthy growth figures, the production of the most important agricultural product, grain, had stalled after a 10 % rise in 1990. Especially the continued inconsistency of the agricultural reform plan was of a major influence. Again, the leadership tossed and turned the agricultural sector between heightened individual freedom and mandatory rule. Markets were opened, and closed again. Production of grain was free, and partly returned under mandatory planning. Procurement prices were rising, but were controlled again as soon as the rises became too high (FT, 7-11-94; Ec, 18-3- 95, p. 24)⁴⁶. At the same time, agricultural input prices rose much sharper, turning the terms of trade against agriculture (Harrold & Lall, 1993, p. 3).

The illegal practise of paying farmers in IOUs which some bureaucrats had started with in the previous reform period, also continued to undermine farmers' confidence during this period. The situation of the grain procurement system in the year 1992 is described by the World Bank (1993, p.22): "The problem of stagnating real incomes for farmers has been made worse by the increasing reluctance of the specialised banks to finance grain procurement. Grain purchasing agents had only 17 % of the Y 60.5 billion to meet the targets

⁴⁶ China Daily, 28 April 1995, reports that in 29 out of the 35 nation's major cities the authorities have re-introduced grain coupons since last winter which enables the urban population to acquire grain under the market price. The State Statistics Bureau also "blamed the meagre grain supply for the 21,7 per cent inflation rate last year."

for grain procurement following the 1992 autumn harvest. The People's Bank of China covered 70 % of the shortfall with emergency bridging loans (which coming as it did over and above the credit ceilings was in itself inflationary), with the difference of 42.4 billion being made up with government IOUs."

Again, progression in the institutional framework was delayed, which resulted in a continuation of inefficient land use and the slackening of the rural infrastructure maintenance (Chapter 4.5 and 5.4). Neither the leadership nor the local authorities performed the necessary maintenance of water works, irrigation systems, dikes, roads, bridges, and forests. This situation also had its repercussion on the environment. Environmental degradation like desertification, deforestation and soil erosion increased. This affected the soil quality and thus the land productivity. The affected areas were mostly situated at the Chinese Northern and Western borders. Provinces that were already poor. The reason why this environmental degradation might become disastrous in the coming decades is the fact that agricultural production growth needs to come from increased land productivity (World Bank, 1991, p.13). The absolute amount of arable land is declining annually due to construction, urbanisation, industrialisation, and environmental degradation. China has been needing to feed 25% of the world's population with the proceeds of only 7% of the world's arable lands. The population, however, keeps on growing and will need to be fed now and in the future⁴⁷. This applies especially to the remote inland provinces, which cannot easily be reached by transportation.

⁴⁷ The decline in land productivity, the rise in the consumption of grain intensive food stuffs in the richer areas, the urbanisation and the industrialisation all together might cut back the present grain output by 20% between 1990 and 2030. "The result, according to Worldwatch will be a Chinese grain import requirement of 213-378 million tonnes by 2030. Daunting when compared with the world's current total exportable grain surplus of barely 200 million tonnes" (FEER, 27 Oct 94). China Daily (29 April 1995, p. 4) reports on the issue that "in 2020, the grain yield is expected to be 400 kilograms per mu (0,07 hectare) , compared with 27 kilograms pe/mu in 1993. This could be achieved through advanced technology, the increased use of chemical vertilizer and the increase in irrigated areas".

What also makes it a critical development is that most of the environmental degradation might prove to be irreversible (Smil, 1993). This, in its turn, reduces the income generating capacity of the rural population in the poorest provinces that have to live off farming.

The strong development of the collective and private industry influenced the agricultural sector substantially. The collective and private industry rise had resulted in a considerable increase of the national income. This translated into a higher demand for cash crops, albeit not equally across the country. In practice it was the income of the Coastal provinces that rose fast, not the income of the West and Central provinces. Consequently, the farmers in the richer Coastal areas were able to respond to the higher market demand in their region and subsequently generated a higher income. The farmers from the West and Centre could not profit from this Coastal demand due to the lack of transportation facilities and distribution networks. This withheld the farmers in the hinterland to specialise on any (often perishable) agricultural cash crops (see Table 14A).

As mentioned in the discussion of the previous reform period (Chapter 5.2), it was partly the success of the collective and private industry itself which, in combination with the distortional agricultural pricing system, lowered the profitability of the agricultural sector for the leadership, the local authorities and even the rural population itself. This resulted in capital, that previously was used for investments in the agricultural sector, to be transferred to the industrial and commercial sectors. The central government had already ceased to invest in agriculture since the beginning of the eighties. After 1992, only around 6 % of the total state budget expenditure was spent on agricultural support, against 10 % in the seventies (Table 5).

Not only most of the agricultural surplus funds were redirected towards rural industries, also a lot of capital specifically designated for agriculture was re-routed. In the rural areas, some local authorities levied additional and illegal taxes on their farming community, used designated agricultural funds, used most local banking credit and resources by simply issuing the mentioned IOUs for agricultural produce as well as for money cheques sent home by migrant workers. In other words, corruption started to mount, which in contradiction to the collective sector, had negative effects on the agricultural sector. Many articles in newspapers and magazines reported frequently on farmers' uprisings in different parts of the country and most seemed to have been caused by some sort of corruption. In 1993⁴⁸, the Far Eastern Economic Review reported that over 200 cases of peasant uprising in nearly a dozen provinces had been recorded in 1992 alone (FEER, 15-7-93, p.68). For that same year, the Economist reported on an infamous incident in Renshou (Sichuan province), where peasants rioted against an illegal local tax. "They set up road blocks and beat and kidnapped local party leaders and attacked government offices. When ...a squad of paramilitary policemen arrived to arrest the leaders of the revolt, they were surrounded by thousands of stone-throwing peasants." (Ec, 19-6-93, p.59). Nearly 300,000 Hunan peasants almost starved after local cadres sold off state provided relief grain (FEER, 27-1-94, p.15). Finally, "In 1993... at least 830 incidents of rural rebellion involving more than 500 people each were recorded, including 21 cases involving crowds with more than 5,000." (Ec, 18-3-95, p. 23). It were Deng's own words which expressed the fear that these uprisings started to develop among the

⁴⁸ Additional articles are: FT, 14 June 1993, *Chinese peasant riot over tax rises*; FT 2 July 1993, *China tries to quell rural fury*; FEER, 27 Oct 94, *The reckoning*; SWB, FE/2243 S1/2, 4 March 95

leadership "...if there are economic difficulties in the 1990s, they will be in agriculture."
(FEER, 15-6-93, p. 69)

The dire state of the agricultural sector also had other effects on the social and political stability of China. A direct effect was the growing urban - rural divide; the average income in the cities was nearly three times as high as the rural income (Ec, 19-6-93). By 1994, for example, the disparity between Guangdong's richest and poorest urban district was 34 fold (SWB, FE/2237 S1/4, 25 Feb 95). Besides this urban - rural division, there was an increasing regional disparity (see table 14 A).

Also, because the control on individual movements had lessened during the reform period, impoverished or 'surplus' farmers increasingly were able to migrate to the urban areas in search of a higher income. The 'floating' population of migrant labourers was estimated to be around 200 million (FEER, 1-9- 94, p. 46). Unfortunately in the urban areas there has not always been enough work, and the work that was available was often low-paid construction work. In addition to the work situation, there was the housing situation. In the urban areas there was already a huge shortage of adequate housing facilities. The arrival of migrant labourers put even more pressure on the towns and cities. Many migrant labourers therefore either have been living on the streets or in the shanty towns that one nowadays can find around some of the bigger cities. The total surplus labour force in the agricultural sector has been estimated to be around 130 million. If the situation in the agricultural does not improve, these will certainly be forced to migrate to the cities. This could in certain areas negatively affect the social stability.

6.6 Economic bottlenecks

Both China's inadequate transport system and energy provision remained serious obstacles in its economic growth potential. The transport system was virtually running to capacity. During 1993-1995 (June) many infrastructure and energy projects were considered on both local and national level. One of the major problems with the actual execution of the plans was the overheated economy and the disagreements on the finances. The leadership recognised and acknowledged the need for infrastructural investments, but it could not do much else then try to slow down the economy, especially in the construction sector, by credit squeezing and delaying the implementation of the actual projects. At the same time, many provinces tried to gain approval for as many projects as possible. Besides their search for banking loans, the provinces opened up many projects to overseas investment capital and technical expertise. At the end of 1994, the Far Eastern Economic Review (10-11-94) reported on the progress of this dilemma: "...foreign companies responded enthusiastically... Asian infrastructure funds targeting China began to sprout, raising several billion US dollars...But after one foreign investment which gained a return on his investment of over 25%, the Chinese leadership halted the projects. Undecided over how much foreign control to allow in this key area - and how much foreigners should be allowed to earn - Beijing's policy makers are delaying more than 50 proposed power plant deals. This year just two have been endorsed..." .

The influence of this schism in interests between the provinces and the leadership was clear. Rightly or wrongly, by delaying the projects the leadership was putting the breaks on the development of the Coastal provinces. At the same time, the inland and especially the

Western provinces were either hampered or in other cases outright unable (due to a lack of financial resources) to develop the necessary infrastructure and energy supplies that would enable them to catch up with the economic development of the Coastal areas⁴⁹. This divergence in interest was one of the factors that reduced the co-operative behaviour of the provincial authorities in the leadership's decision making process, thereby weakening the power position of the leadership.

By 1995 this situation had not improved and the official prediction was that the entire country would suffer peak hour power shortages throughout the year and that it would be an unavoidable and common occurrence that the power supply would be cut off during peak hours in order to limit power consumption (SWB, FE/2261 s1/7, 1995; CD, 4 May 95, p.4). Nevertheless, I may assume that as a result of the low investment in this sector over 1990 - 1995, this situation would not have improved much. Thirdly, an additional investment problem was created by the under-pricing of coal which made it difficult to justify new investments and did little to encourage preservation. The state's planned and procurement price was far below the free market price.

⁴⁹ China Daily, 1 May 1995, p. 5: "According to an official with the State Development Bank, the delay of fund allocation from local authorities and the heavy burden of debt repayment on power projects have become the major hurdles hindering development of many projects....many power projects will face tough financial situations this year..together they will have to repay about 5,2 bn yuan in principals and interest on loans....However, by the end of March only 280 million yuan worth of bonds had been redeemed."

6.7 The People's Liberation Army

The aftermath of the Tiananmen incident was still working in favour of the military's power. Faced with growing regionalisation and rural disturbances, the need for a strong military backing for the leadership was becoming more important. The trade-off seemed to be expensive and self-enforcing. On the one hand the leadership was forced to designate more of its financial resources to the military, but on the other hand wanted to regain total control over the PLA.

Firstly, according to the 'Western budget method' (table 5) military expenditure remained around 8%. However, the military's business affairs in civilian and international arms industry, which largely went outside the control of the government, were allowed to expand, thereby raising the army's financial resources. Nearly 70 % of the defence industries' output was classified as 'civilian'. It was already the case that in some consumer industries the military was the dominant producer: e.g. more than 60 % of China's output of motor cycles, washing machines and electric fans. In the electronics industry they formed more than 50 enterprise groups and subsequently became its main production force (SWB, FE/2252 s1/2, 31 March 95). And more recently, the PLA seemed to have ventured into the financial markets (currency, real estate and stocks). The other profitable industry the PLA was involved in was ofcourse the international arms sales. However, as mentioned, the performance failure of Chinese arms in the Gulf had resulted in an export slump. This factor, combined with the wish to procure higher quality foreign arms, pushed the PLA even more into the civilian industry, both for domestic consumption and export (FT 9 July 93).

A large part of the profitability of the PLA's industry (both civilian and defence) came from the fact that it operated outside the civilian economy and thus was not bound by the same rules and regulations as the civilian industry, most notably the tax rules. It also had the advantage of possessing its own distribution networks via air and road. This situation provided the 'military civilian' industries with a distinct advantage over the regular civilian industry. 'For a system where guanxi or connection, is the rule for doing business the army holds the ultimate advantage. Not only does this distort the market signals, but it opens the way to dangerous freelance deals.' (FEER, 17-1-94; p.5). The profits made were ploughed back either into the industry or into the military apparatus itself.

The consequence of these developments was that it gave the PLA more independence from the political power of the leadership and its financial contributions. The counter actions of the leadership to dam this rise in independence led Deng Xiaoping to instigate military changes. At the Party Congress of 1992, he sacked the top military leader Yang Baibing (political commissar and general secretary of the Central Military Commission) who was accused of trying to build his own power base within the PLA in order to take over the leadership after Deng Xiaoping's imminent death (SWB FE/2262 G/5, 27 March 95). Furthermore, an extensive rotation of regional commanders and troops from all seven of China's military regions was implemented (Ec, 1 May 1993, p.66).

Whether these latter political measures truly have stemmed the PLA's growing independence is doubtful. Their increased financial resource base and the leadership's increased need for the PLA's backing have provided the PLA with increasing political and economic bargaining power. Fortunately for the leadership, the power seems largely to rest on the PLA operating as an homogeneous entity. This reduced the threat of the army breaking up

into regional armies that would collude with local bureaucrats in an effort to break away from the country:

- the advantage of a united PLA lay in its national infrastructure and therefore the possibility of producing either consumption goods or arms, cheaply in one region and transporting it for sales across the whole of China.
- The financial and political strength of a united PLA would always be more extensive than the sphere of influence any regional PLA would be able to project. A united PLA provided a regional army with more independence, and thus power, vis-à-vis its regional bureaucrats.
- Since the PLA had extensive defence and civilian business interests, and the leadership's national macro policies were not (yet) that detrimental to these interests, it stood to lose much more financially if they participated in an internal war against other regional armies. It seemed financially much more beneficial *not* to break up.

Finally, to address the issue of the impending political power play which is expected within the leadership as soon as Deng Xiaoping's has deceased and whether the factions might use the PLA to solve any disputes, one would estimate that this seems unlikely. The power of the PLA is no longer based on its links with the leadership, but is based firstly on the leadership's ultimate need of the *PLA's* backing its own power position, and secondly on its business interests. It does not seem to be advantageous for the PLA to involve itself in the leadership power struggle.

6.8 Growing provincial disparities

The emergence of regionalism during the previous period continued to develop further. The economic disparities between the provinces in both agriculture and industry kept growing which increased the complexity of producing reform measures and policies that were beneficial for both the leadership itself as well as the targeted interest group. The common denominator within the same interest group but of different regions was difficult to analyse, and thus also the interest group's members' collective reaction to individual reform measures. It seemed, however, that the balance of power between the different interest groups *within* each province had remained more or less the same as before.

Most of the economic facts behind the emergence of regionalism largely remained unaltered during this period. The regional development policy that gave each province a different industrial focus point was not renounced. The Western and Central provinces still had to direct their attention to the primary industry, the Coast to the secondary industry (CD; 25 April 95, p.4) Nevertheless, all provinces tried to implement similar reform measures that had led some Coastal cities to fast economic growth, with or without the consent of the central authorities. The provincial governments worked hard to create favourable investment facilities like infrastructure, investment parks, tax breaks/holidays and cutting of bureaucratic red tape. Other less positive, isolationist measures were also often included in these reform plans: tariffs, trade barriers and import control at the provincial borders. Many Chinese towns and cities set up development zones similar to the existing official coastal development zones. Their number rose from only 117 at the end of 1991 to 10,000 at the end of 1992 (Harrold & Lall, 1993, p. 6/7). In June 1995, on the official level, an extension was

announced to China's open door policy in 28 cities along the Yangtze river and to 13 border cities in the North East, South West and North West regions. Despite these efforts it was the Coast that continued to attract the vast majority of investment, from both domestic and international investors.

As mentioned in section 5 of this chapter, nationally the agricultural sector had seen a reversal in its economic liberalisation policy. The provinces that were largely agricultural were hardest hit. Unfortunately, most of these were also in the West and Centre of the country.

In the Coastal provinces, the economic regulations passed down from the leadership started to hamper a continuation of economic development. Due to the new fiscal system and economic growth, the Coastal provinces were paying more to the central government than they were receiving. In 1979, for example, the central government used to provide 80 % of the funds spent by Guangdong province on infrastructure and capital investments, but by 1992 this figure had gone down to a mere 2% (Goldstein, 1993, p.21). In other words, the central authorities were becoming more of an obstacle than a stimulator to their development. At that moment, it seemed that a turning point within the relationship between the leadership and the provincial authorities was being reached. The rise of wealth and large investments by collectives, individuals *and* provincial bureaucracy and military themselves, had created a new vested interest within these groups in a continuation of the economic reform process. This provided the provincial authorities with a tremendous amount of political backing in their dealings with the leadership. In addition, the more the central government's need for financial resources grew, the more the political leverage of the Coastal provinces grew too.

Both politically and economically, it became more rational for the Coastal provincial authorities to try to evade or even ignore the leadership's regulations and directions. Examples of provincial 'disobedience' became more often headline news. This year, for example, the central government announced that it wanted to bring China's growth rate down to 9 % from 13% last year, and called on the provinces to slow the economy. Guangdong's response has been to ignore their instructions and has carried on profiting from its inflows of foreign investment and its synergies with Hong Kong. The economy of its Special Economic Zone, Shenzhen, next to Hong Kong, grew by 30% in real terms last year and it showed no signs that it intended to limit its growth to a 'mere' 9% anytime soon. Vice premier Zhu Rongji even acknowledged the fact that many regions had ignored some of his directions. Despite a drop in the retail price inflation from October 1994 to March 1995, inflation remained above 20% and started to climb from April onwards. By May 1995, Zhu Rongji was forced to send out inspectors to all regions because many had disregarded the curbs on price rises and defied a crackdown on new construction projects (IHT, 29 May 1995). Another direct indication is the fact that 'the increase in taxes collected in the provinces was far smaller than the provinces' estimated 20% GDP growth. ...In other words , the government is getting a smaller proportion of their aggregate output.' (FEER, 25 May 95, p.22). Consequently, people started to attribute their economic prosperity far more to their provincial authorities than to the leadership.

The Central and Western provinces were in an entirely different situation. Their financial dependency as net recipients of central government funds took any potential political leverage on that front away. Nevertheless, both the population and the authorities did object increasingly to the biased treatment they were receiving from the leadership. The

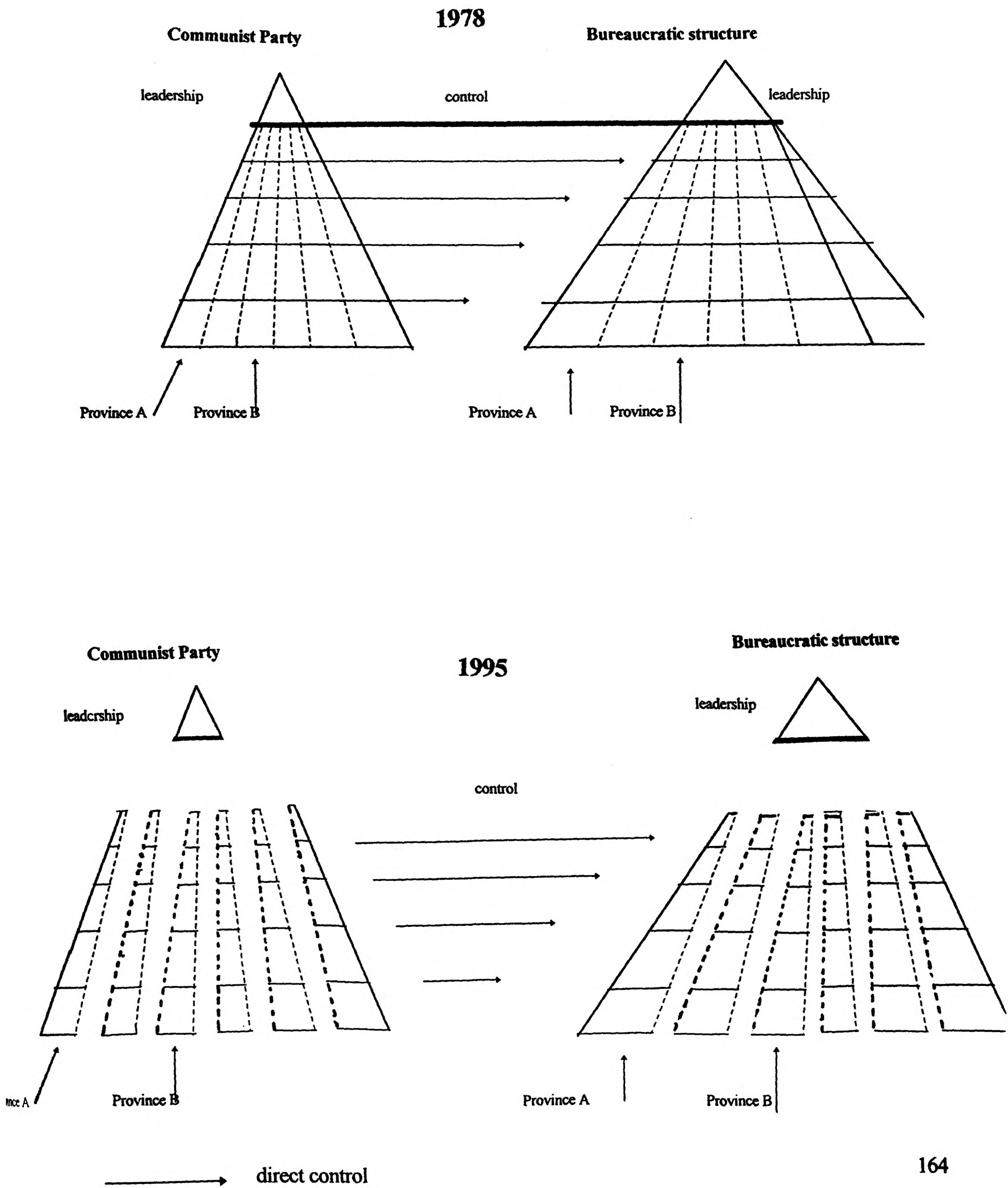
authorities mainly because they saw their colleagues in the Coastal provinces become rich while their own position was not bringing them much more wealth or esteem. As mentioned in section five of this chapter, the farming population objected more out of pure necessity as in some regions the farmers saw their economic situation stagnating and in some cases declining. With nothing much to lose they voiced their opinions increasingly through demonstrations.

The overall result of these diverging economic growth patterns seemed to be that the provincial authorities were being increasingly pushed by their own bureaucratic structure and local interest groups to stand up for their interests. In practice these interests were not necessarily in line with the national economy or the leadership's interests in the particular province. Gradually they started to behave more like representatives of their own constituency than as the representatives of the national Communist Party and leadership. Contrary to popular belief or wishful thinking in the West, this does not seem to indicate a total disintegration of Chinese society. The picture that has emerged seems more likely to enhance the dissolution of the leadership's supreme power position towards the provincial authorities.

The process is most clearly illustrated by showing the changes that seemed to have taken place in the organisational triangles that I presented in Chapter 3 depicting the bureaucratic structure and Communist Party control over it. By 1995, the large national triangle had fallen apart into many smaller provincial triangles with a floating leadership triangle above (see Graph B). It seemed that the inner organisational structure of the provinces largely remained the same, with the Party and provincial authorities at the top taking over the role of the leadership. Importantly, this meant that the military kept their previous privileged position

and power, and that their business interests were safeguarded. Therefore, even if the leadership wanted to, it no longer seemed to preside over sufficient means to turn the military against the provincial authorities, neither in financial resources or power transfer. Due to the continuation of autocratic rule, the social stability of most provinces remained fairly intact, the exception being the poorer inland provinces. Hence, my view that although during this period the Chinese communist system has been disintegrating, it is by far from the road to democratisation.

Figure 2 - Leadership's control over bureaucratic structure in 1978 and 1995



Note: At the beginning of the nineties the leadership became more or less detached from the 'old' structure. Each province now formed its own little triangle of power, with at the top the provincial authorities. In other words, the leadership had lost most of its direct control over the provinces.

6.9 Changing constraints and the balance of power

During 1992 to 1995, the dynamics of the reform process had altered the playing field to such an extent that one had to start visualising it in a three dimensional form in order to see the leadership's reform potential. Indeed, the leadership had increasing difficulties managing the economy according to its own needs. The internal contest that broke out into the open as Deng Xiaoping's approaching death became imminent did not help much either.

Neither during this period did the leadership instigate any institutional changes in the political atmosphere. Although it became increasingly clear to all parties involved that the changes within the economic system required a change in the political system if the *leadership* wanted to retain its supreme rule, the leadership had manoeuvred itself into a deadlock and was not able to progress. Its members had been waiting for the death of Deng Xiaoping before making any political moves, but already for many years the gentleman in question had refused to die, and therefor created this political vacuum. The political constraint was as strong as ever.

It seemed, however, that the deadlock was not negative for all. The provincial authorities were the major benefactors. Leaving the internal structure of their province the same, they had taken over much of the political power in the decision making process from the leadership, albeit in varying degrees depending on their location of Coast or hinterland (Assumption 10). Especially for most of the Coastal authorities it was economically and politically more beneficial to act as representatives of their own province than of the national state/ leadership (Assumption 4, 5).

The decentralisation of power that actually had been instigated by several reform policies of the leadership, was in principle not negative and certainly partly planned, but it should have been placed into a new political framework for it to be positive nation-wide. Without this framework, the emergence of regionalism became a more dominant factor in China. Provinces started to act upon that what was good for their own economy which did not always add to the national progress (trade barriers, provincial border patrols and favourable tax and credit policies).

The official acceptance by the Communist Party of the development towards a socialist market economy provided a definite positive signal to domestic and international investors. The planned part of the economy kept declining annually. Many other positive reforms were introduced, e.g. the laws on stock markets, private ownership and copy rights. However much potential these measures had, two problem areas that largely seemed to rule the government budget and thus the economy the leadership again had not been able to structurally change: the state owned enterprise and banking sectors (Assumption 12). The technical constraint therefore had been altered, but was still strong.

The collective and private sectors were breaking their own records each year, producing over 50% of the national output. Investments flourished and domestic business expectations were positive. But again, the leadership was not able to translate this success into significant higher tax revenues for the central government. At the same time, the leadership kept its food and state owned enterprise's subsidies at its previous high levels. The situation this time not mainly solved by resorting to the money printing press but by domestic and international borrowing. Unsustainable as the budget deficit level was, the leadership saw no other political or economic solution. The resource constraint did not seem to get any weaker.

The influential changes in the balance of power that had started in the previous reform period seem to have deepened. Moreover, a distinct split had taken place within some of the interest groups as a result of the regional disparities. Their common characteristics and interests had faded. In addition, the leadership saw itself faced with an attributability problem. Most people nowadays attributed most changes within their economic situation to the provincial authorities and no longer to the leadership:

- the Coastal bureaucracy saw its power increased through local economic growth (tax revenues) and a further separation from the centre towards self-government. The Western and Central bureaucrats were financially too dependent on the leadership basically to change the balance of power. Another major difference between the provinces was the structure of their local economies and therefore the policies that they backed. The Western and Central provinces had little collective and private industries, but many state enterprises. The Coastal provincial economies were seeing a surge in the former two industries.
- Even though it did become harder for state enterprises (especially in the Coastal provinces) to keep its operations in the old style, no major structural breakthroughs were reported. Factors like subsidies, credit facilities and life time employment were basically still the main theme. Nevertheless, it did seem that the changed economic environment as well as some structural changes that were being set up (social welfare system, education etc.) were slowly influencing the attitude of both managers and employees of the state enterprises.
- Largely due to its business interests and the growing need for political backing, the army had seen an increasing independence from the leadership. Their legitimacy and way of

doing business, however, was largely linked to the supremacy of the Communist Party and the leadership. The balance of power had been altered and become somewhat stronger in favour of the army. Most importantly, however, this did not seem to carry much danger for the leadership.

- Due to a continuation of stringent controls on free speech and any dissident voices, the urban population seemed to have just one thing in mind: to make money. Because they knew that their local authorities also had extensive financial interests in their businesses, they were largely able to keep up their level of consumption spending and investments. This in spite of the fact that the leadership had ordered otherwise. The power of the authoritarian state was still very much present, but it seemed more of a provincial kind.
- Politically and financially it cost the leadership too much to liberalise the agricultural economy. It induced the leadership to take instead the risks of the destabilising effects of the rural uprisings and rural-urban migration. The regression of the agricultural sector policies affected the West and Centre more than the Coast. The differences between the rural country sides became apparent as most uprisings were in the hinterland. Some farming communities did not seem to have much more to loose.

7 CONCLUSION

What has been the logic behind the Chinese reforms? To find the answer to this main research question, I developed an analytical framework for autocratic economies based upon political science and economic theory. It was to examine not only the economic reform policies on their contents, implementation and continuation, but also the political decision making process that surrounded them. Therefore, at all stages of the analysis the interrelationship and the bargaining processes between the autocratic leadership and the different interest groups were made central. The basic assumption of the framework was that all individuals, including bureaucrats and autocrats, were rational and taken to maximise their own power and money subject to constraints. The focus was placed on those reform measures that were prominent components in World Bank and IMF reform and adjustment programs: price liberalisation, balancing the budget (involving mostly cuts in defence budget and state subsidies), state owned enterprise restructuring/ privatisation, bureaucratic deregulation and currency devaluation.

The idea behind the framework was that after a new leadership had risen to power, it would start an economic reform process in order to secure their power position. If you looked from the onset of this reform process at the government's reform possibilities -especially its impossibilities- a certain 'playing field' would emerge from within which the leadership's subsequent (in)actions could be explained. Over time, the reform measures that were implemented affected the playing field and, therefore, one had to make a constant

reassessment of its formation in order to see the logic behind each succeeding reform move. The four borders of the field were basically the economic system (technical constraint), the political system (political constraint), the financial resource potential (resource constraint) and the balance of power. The framework hypothesised that within this field an autocratic government would optimise its power through balancing the political viability with the economic rationality of each individual reform measure.

The subsequent application of the framework to the Chinese reforms during 1978 to 1995, divided the process into four periods according to the implementation of its most important reform measures. The first period lasted from 1978 to 1984 and was marked by extremely successful agricultural reforms. From 1985 to 1986, the leadership introduced fiscal and township and village enterprise reforms that triggered off an enormous growth in the industrial sector. The years 1987 to 1992 were marked by a backtracking on the agricultural reforms, the leadership's problems with containing the fast growth of the economy and its failure herein culminating with the 1989 student uprisings. The final reform period 1992 - June 1995 saw the official acceptance by the Communist Party of the 'socialist market economy' and further moves towards liberalisation of both the state enterprise as well as the collective sector.

At the beginning of the first reform period, the technical constraint of the Chinese playing field was marked by the communist planning system, by the domination of the inefficient and money wasting state enterprise sector and by the agricultural commune system which had gradually brought output to a standstill. The resource constraint consisted mainly of the leadership's dependency on the state enterprise sector which contributed 86% of the budget revenues. The political constraint was formed by the autocratic power structure

between the Communist Party, the bureaucracy and the rest of the interest groups, the prevalent bureaucratic decision making process of consensus seeking and the leadership's problem of receiving asymmetric information. The balance of power was the fourth constraint. Interest groups would bargain with the leadership about individual economic reform measures. The more power an interest group had the more able it was to alter or to oppose any measure that carried negative consequences for their own power position. The strongest interest groups in China were the People's Liberation Army, the bureaucracy and the management of the state enterprises. To stay in power, the leadership depended both upon their backing to stay in power and their co-operation with the actual implementation of the reform measures. The urban population gained power as an interest group from their potential threat of unrest. The rural population were too far away and consequently had little influence on the power of the leadership.

From the onset of the reforms it was economically quite clear that the state owned industry sector had to be reformed. The majority was inefficient and lossmaking, and put a break on other economic sectors' development. Nevertheless, the main difficulties that the leadership was faced with (as more fully described in the playing field) left little room to manoeuvre: the planning system, its dependency on the enterprises' revenues, the fact that the industry was overrepresented at the top levels of the bureaucracy and the threat of dissatisfied unemployed urban workers. For over 17 years the leadership tried to change the enterprise system. It announced plans and tried to implement several measures, but it did not have much success. The political inviability of true state sector restructuring outweighed its economic rationality time and again. Most price liberalisation measures were doomed to fail as the state enterprise input and output prices still did not reflect their true cost price. Recently, however,

it does seem that the constraints have weakened considerably and that the moment for real change might be near: the government budget's dependency on the state owned industry has been lowered to beneath 50%; the success of the private and collective industries has challenged the management of state enterprises and its workers to join in the free market; as it also increasingly provides the urban population with alternative employment opportunities.

The agricultural sector never had much influence on the power position of the leadership. Attention went as far as ensuring that it produced the basic amount of food necessary. Its insignificance for the leadership was heightened by its small contribution to the budget revenues (3%) as well as its small part in its budget expenditure (7%), and by its scarce representation at the top levels of the bureaucracy. While the state enterprise sector had 14 ministries, agriculture had only one. However, it seemed that it was exactly because of these reasons that at the beginning of the reform process the different provincial authorities were allowed to experiment with agricultural reforms.

The most successful local reform (the household contract system) quickly spread across the country, after which it was officially endorsed by the leadership. Its success mainly came from the abolition of the commune system, the introduction of free markets for part of the agricultural production, and higher state prices for the remainder of the output. This created not only the financial surplus that was later used to build the collective enterprises, but it also provided both the fiscal and collective sector with its reform foundations. The price the leadership had to pay for this reform was unexpectedly high. However economically rational it was, the leadership apparently did not deem it politically viable to charge urban consumers the full price for these food products as it increased its food subsidies from 1% of the budget in 1978 to 14% in 1984.

As time went on this became an unsustainable drain on the leadership's financial resources. When, in addition, during the second half of the eighties the success of the collective sector and the problems of the state sector began to overshadow the agricultural sector, the leadership reversed many of the agricultural price liberalisation reforms. In the years after, this cycle of implementation and retraction was consistently repeated, with only the basis of the household contract system remaining in place. The subsequent uncertainty in the agricultural sector led to a slow down of efficiency enhancing investments and in the production of the most important food staple grains. A situation that might become dangerous for the food supply in the future. In addition, it has also recently led to repeated farmers' uprisings in the poorer Western and Central regions which are entirely dependent on agriculture.

The leadership derived a large part of its autocratic power from the threat of force. The People's Liberation Army provided them this crucial element. In the last years of Mao's rule, the army realised the position it was in. It had become inefficient, lacked professionalism, and operated with very old, inadequate equipment. In need of change, it consequently backed Deng Xiaoping when he advanced to take over power at the end of the seventies. In return, it received financial backing and independence in its handling of military affairs, but later more importantly, also in its own civilian industries. This latter fact provided the army the means of producing goods outside the control and taxes of the government, and allow it to successfully enter the growing civilian consumption market. Their current increased financial resource base and the leadership's increased need for the army's backing (as proofed by the 1989 Tiananmen student and the nineties' peasant uprisings), have given the PLA new bargaining power. Nevertheless, it seems that the basic balance of power has

not altered much, and the newly gained power is used to further their civilian business interests. Their present position only seems to be guaranteed with the survival of the autocratic state and its operation as a national entity.

The final reform measure the case study focused on was bureaucratic deregulation. Being an autocracy and a communist state, the bureaucracy formed a vital link for the leadership in their strive for power and success. They were the people that had to do the actual implementation of the reform measures and look after their progress. Rationally speaking, they would only cooperate with measures that would not leave them worse off. The failure of the state enterprise reforms is an example in which their role was extensive. The local authorities were financially not able to or simply did not want to supply most of the social welfare functions that the state enterprises fulfilled, like the provision of housing, education and pensions. Furthermore, they also feared urban unrest.

The main bureaucratic deregulation reforms only started with the introduction of the new fiscal and collective enterprise reforms half way through the eighties. This presented the bureaucracy with a real positive sum game. It gave them the freedom to raise additional local taxes, and participate in and thus gain from the development of collective enterprises. In the last decade, these developments granted them increasing financial independence. At the same time, the leadership started to loose considerable control over the local authorities. When at the beginning of the nineties the economy started to overheat the loss became a specific threat to the leadership's power position. Measures that affected the slowdown of the collective sector or the investment drive of the state enterprise sector were largely ignored. The balance of power between the leadership and the bureaucracy had definitely moved in favour of the bureaucracy.

This move, however, did not happen to the same extent in all provinces. During the second half of the eighties, one of the results of the economic reform process rose to the surface which the leadership seemingly had not fully counted on: the emergence of regionalism. The reforms had not produced the same effects in all regions. It were especially the Western and Central provinces, dominated by the agricultural and state owned enterprise sector, which had lagged in their economic development. The profitable collective sector was mainly developed in the Coastal areas. In addition the Coast also received a vast majority of the foreign investments and eventually was even encouraged by the leadership to develop first. The direct consequences for the leadership were firstly, that as most interest groups had started to loose their common characteristics, it became increasingly complex to produce reform measures and policies that were beneficial for both the leadership as well as the targeted interest group. Second, the increased wealth granted the Coastal authorities financial independence from the leadership, which basically meant a grave loss of power.

These important consequences and the rest of my case study findings indicate two things. First, the reform measures were by and large developed through bilateral bargaining processes and on an individual basis, in other words it had little coherence with an overall macro economic strategy. Therefore a fair amount of interlinking effects between the individual reform measures on one or more of the borders often must have been unintended. At times this still produced favourable results, at other times this may have led to a far greater decline in central control or power than anticipated. Second, the leadership rose to the occasion. Unfavourable results for the power position of the leadership, either financially or politically, were consequently followed by a search for new reform measures which would turn the situation around as well as by a constant reassessment of the leadership's power

position. The outcome was a frequent change in the reform plans. This often led the West to perceive the Chinese economic reforms process as being ad-hoc and irrational. My case study, however, indicates that the Chinese economic reform process was produced with a high degree of rationality. The logic behind the reforms was that the leadership would only implement those reform measures it had been able to balance on their political viability and economic rationality. The fact that interlinking effects produced unwanted results does not refute the argument, moreover it backs the hypothesis' claim of the individual treatment of reform measures.

Finally, although the leadership has lost a great deal of its power and control over the provincial authorities it does not seem to indicate the start of a total disintegration of the Chinese society and downfall of the leadership, but merely a gradual passing over of power to the provincial authorities. In principle, the economy is doing well. Despite the political system's autocratic nature, the lack of freedom of expression and the dismal human rights' record, general welfare is rising, expectations among most people about their future is rising and the economic outlook is positive. It remains to be seen whether China will follow other former communist countries on a road to democratisation and/or break-up. Rationally speaking, the army, the Party, the bureaucracy and the state industry have more to lose following that path at present than they would stand to gain. It seems more likely that China is heading for an autocratic version of the federal state. The paradox of the Chinese reforms remains with the leadership. To stay in power they had to reform the economy and by achieving this, they gradually lost the balance of control.

Although more research needs to be performed on the applicability of the framework for other countries, I would like to conclude that it enabled us to analyse the foundations of

the Chinese economic reform process and demythologise the success and power of the leadership. Above all it provided a structured angle, which gave more clarity and coherence in my findings than when I would have had using either only pure deduction, political science or economic theory in my methodology. However, the stringency of the framework did limit not only the inclusion of many other influential variables like religion, cultural heritage, and gender or other interest groups, but also kept the focus primarily on the leadership. Therefore, the framework did not address the reform process and its effects on certain areas in society or specific groups as women, children, parents, disabled, or dissidents. This is where the limitations of its applicability lie. Nevertheless, having established the fact that few research to date has been performed on the entire Chinese economic reform process and all its sectors, my framework enabled us to perform this analysis and provide a comprehensive conclusion, underlining its applicability and hence its value. Despite the relative elementary account of the different reform measures, their origins and results, I have been able to distinguish a common logic in the actions of the leadership which endorses the framework's assumptions and its hypothesis that political viability and economic rationality are prerequisites in economic reform.

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Table 1 - Gross Output Value of Society 1978 - 1993 *

(1,000,000 yuan, at current prices)

Year	Total	State Owned Enterprises (rural + urban)	Collective Owned Enterprises (rural + urban)	Individual Owned Enterprises (rural + urban)	Other Ownership in Industry (incl. foreign, rural +urban)	Construction (Industrial + Rural Sector)	Transportation (Industrial + Rural Sector)	Commerce (Industrial + Rural Sector)	Agriculture
1978	684,600	328,918	94,782			56,900	20,500	43,800	169,800
1979	764,200	367,360	100,770			64,500	20,900	40,900	192,300
1980	853,400	391,560	121,336	81	2,449	76,700	25,000	44,000	192,260
1981	907,500	403,710	132,938	190	3,140	74,700	25,700	49,000	218,100
1982	996,600	432,600	144,242	340	3,940	91,200	28,600	47,400	248,300
1983	1,113,100	473,940	166,314	750	5,040	105,300	31,800	54,900	275,000
1984	1,317,100	526,270	226,309	1,481	7,670	126,300	38,800	68,900	321,413
1985	1,658,200	630,212	311,719	17,975	11,741	165,600	48,800	110,300	361,949
1986	1,904,500	697,112	375,154	30,854	16,306	203,800	59,800	120,200	401,301
1987	2,303,400	825,009	478,174	50,239	27,877	243,100	70,200	141,200	467,570
1988	2,980,700	1,035,128	658,749	79,049	49,532	296,700	83,700	191,400	586,527
1989	3,451,900	1,234,291	785,805	105,766	75,844	283,400	99,000	214,300	653,473
1990	3,803,500	1,306,375	852,273	129,030	104,756	304,300	153,500	187,100	766,209
1991	4,380,300	1,495,458	1,008,475	160,910	159,958	370,000	166,500	203,300	815,703
1992		1,782,415	1,410,119	250,680	263,357	908,470	509,700		908,470
1993	5,146,559	2,330,690	1,305,050	411,450 *		1,099,360	733,500		1,099,360

Source 1978 - 1991: China Statistical Yearbook 1992, pp. 44, 368

Source 1992 - 1993: Statistical Survey of China 1994: Agriculture pp.59; Construction pp.89; SOE + Collective pp.74

*Gross Output Value is the sum of each enterprise in a given sector. In summing the output value of all enterprises the value of the intermediate goods is double counted. Only material production sectors are included.

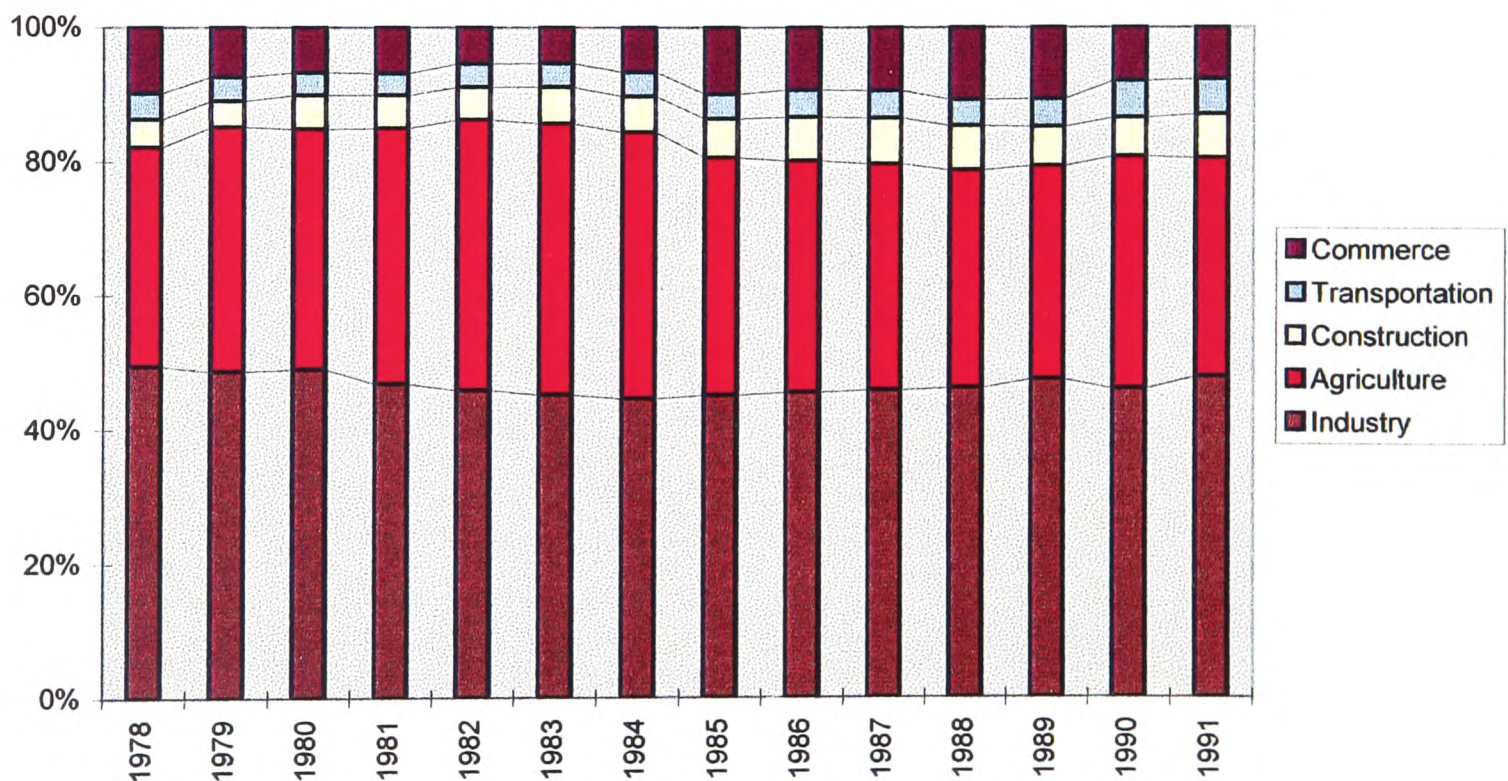
**GOV of Individual owned enterprises and other ownership is only available in one figure for 1993

Table 2 - National Income 1978 - 1991

(1,000,000 yuan, at current prices)

Year	Total National Income*	Industry	Agriculture	Construction	Transportation	Commerce
1978	301	148.7	98.6	12.5	11.8	29.4
1979	335	162.8	122.6	13	12.1	24.5
1980	368.8	180.4	132.6	18.5	12.6	24.7
1981	394.1	184.4	150.9	19.3	13.1	26.8
1982	425.8	194.8	172.3	20.9	14.7	23.1
1983	473.6	213.6	192.1	25.9	16.6	25.4
1984	565.2	251.6	225.1	30.3	20.5	37.7
1985	702	316.3	249.2	40.9	25.9	69.7
1986	785.9	357.3	272	51.4	32	73.2
1987	931.3	426.2	315.4	63.7	38.4	87.6
1988	1173.8	541.6	381.8	78.3	46	126.1
1989	1317.6	624.1	420.9	77.4	54.7	140.5
1990	1438.4	661	500	83.9	78.7	114.8
1991	1611.7	770.3	526.9	105.5	85	124

Graph 2 - Sector Contribution to National Income 1978 - 1991



Source 1978 - 1991: China Statistical Yearbook 1992, pp.29

Source 1992 - 1993: Statistical Survey of China 1994, pp.12

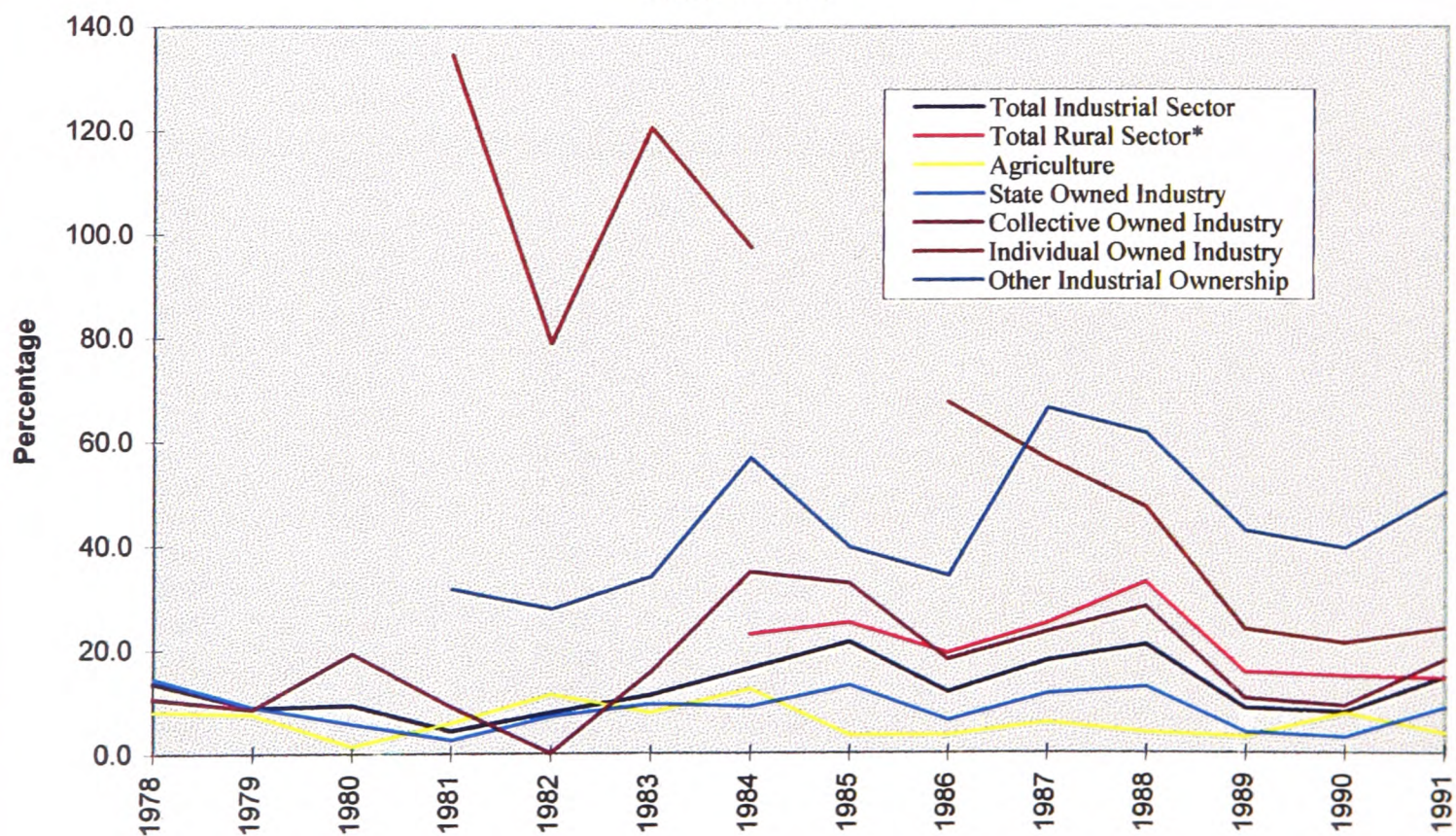
* National Income is the sum value of added net output of all the mentioned material production sectors.

**Table 3 - Real Growth in Gross Output of Industry and Agriculture
1978 - 1991**

(in percentages, preceeding year = 100, based on comparable prices)

Year	Total Industrial Sector	Total Rural Sector*	Agriculture	State Owned Industry	Collective Owned Industry	Individual Owned Industry	Other Industrial Ownership
1978	13.6		8.1	14.4	10.6		
1979	8.8		7.5	8.9	8.6		
1980	9.3		1.4	5.6	19.2		
1981	4.3		5.8	2.5	9.0	134.6	31.6
1982	7.8		11.3	7.1	0.1	79.0	27.7
1983	11.2		7.8	9.4	15.5	120.6	33.9
1984	16.3	22.9	12.3	8.9	34.9	97.5	56.8
1985	21.4	25.1	3.4	12.9	32.7		39.5
1986	11.7	19.2	3.4	6.2	18.0	67.6	34.1
1987	17.7	24.9	5.8	11.3	23.2	56.6	66.4
1988	20.8	32.9	3.9	12.6	28.2	47.3	61.5
1989	8.5	15.5	3.1	3.9	10.5	23.8	42.7
1990	7.8	14.8	7.6	3.0	9.0	21.1	39.3
1991	14.5	14.3	3.7	8.6	17.9	24.0	50.1

**Graph 3 - Real growth of Gross Output Value of Industry & Agriculture
1976 - 1991**



Source 1978 - 1991: China Statistical Yearbook 1992, p. 297, 299, 369

* The Total Rural Sector growth line depicts rural agriculture/ industry/ commerce/ construction/ transportation. Construction, transportation and commerce, however, are not included in the other figures.

** In 1985, Individual Owned Industry grew 108.6% but is excluded from the table in order to keep a normal scaling for the other figures.

Table 4 - Government Expenditure by Account Item

(1,000,000 yuan)

Year	Appropriations for Capital Construction	Circulation Funds	Technical Updating, transformation of enterprises, new product trial funds	Geological prospecting	Administration expenses of industry, transportation, commerce departments	Expenditure supporting agricultural production & administration	Culture, education, science and health care	Pensions and social welfare relief funds
1976	31,125	4,536	3,434	1,596	1,312	4,601	8,549	2,407
1977	30,088	6,568	3,945	1,726	1,443	5,068	9,020	1,876
1978	45,192	6,660	6,324	2,015	1,779	7,695	11,266	1,891
1979	51,469	5,206	7,202	2,167	2,104	9,011	13,212	2,211
1980	41,939	3,671	8,045	2,257	2,285	8,212	14,626	1,031
1981	33,063	2,284	6,530	2,185	2,368	7,368	17,136	2,172
1982	30,915	2,363	6,902	2,305	2,383	7,988	19,696	2,143
1983	38,281	1,289	7,871	2,360	2,788	8,666	22,354	2,404
1984	48,893	996	11,177	2,622	3,066	9,593	26,317	2,516
1985	58,380	1,430	10,342	2,958	3,516	10,104	31,670	3,115
1986	67,182	994	12,985	3,060	3,656	12,430	37,993	3,558
1987	62,182	1,206	12,493	3,029	3,313	13,416	40,275	3,740
1988	63,337	959	15,101	3,251	3,895	15,874	48,610	4,177
1989	62,576	1,209	14,630	3,316	4,501	19,712	55,333	4,960
1990	72,569	1,090	15,391	3,619	4,693	22,176	61,729	5,504
1991	73,975	1,309	18,081	3,834	5,241	24,355	70,800	6,732
1992	76,480		22,360			26,900	79,300	6,650
1993	92,710		42,360			32,190	96,050	7,520
1994	70,000					39,300	127,400	
1995*	74,500					24,400	96,400	

Year	Government			
	National Defence	administration	Repayment of Loans	Price subsidies
1976	13,445	4,101		
1977	14,904	4,332		
1978	16,784	4,909		1,114
1979	22,266	5,687		7,920
1980	19,384	6,679	2,858	11,771
1981	16,797	7,088	6,289	15,941
1982	17,365	8,160	5,552	17,222
1983	17,713	10,220	4,247	19,737
1984	18,076	13,728	2,891	21,834
1985	19,153	14,348	3,956	26,179
1986	20,075	18,243	5,016	25,748
1987	20,962	19,548	7,983	29,460
1988	21,800	23,935	7,675	31,682
1989	25,147	28,477	7,236	37,355
1990	29,031	33,347	19,040	38,080
1991	33,031	37,581	24,680	37,377
1992	37,790	42,460	43,860	32,160
1993	43,250	54,030	33,740	29,620
1994	55,100	47,200	49,800	31,300
1995*	63,100	49,900	87,100	34,100

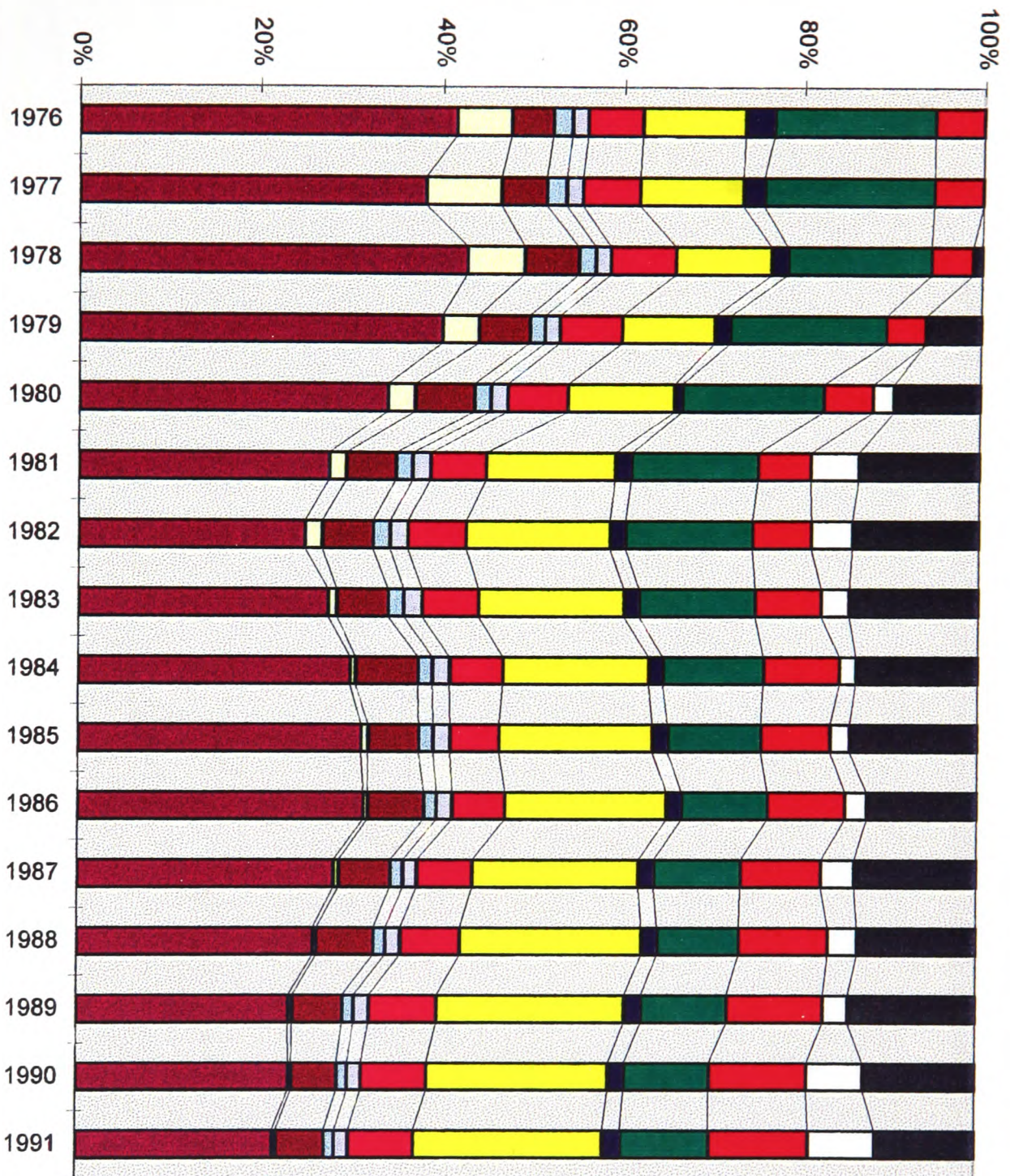
Source 1976 - 1991 : China Statistical Yearbook 1992, p. 195, 203

Source 1992 - 1993: A Statistical Survey of China 1994, p. 39

Source 1994 - 1995*: FEER 16 March 1995. Data of 1995 are the official expected budget figures.

Note: Data which are omitted in the years 1992-1995 we have not been able to find. These items, however, are real expenditure items.

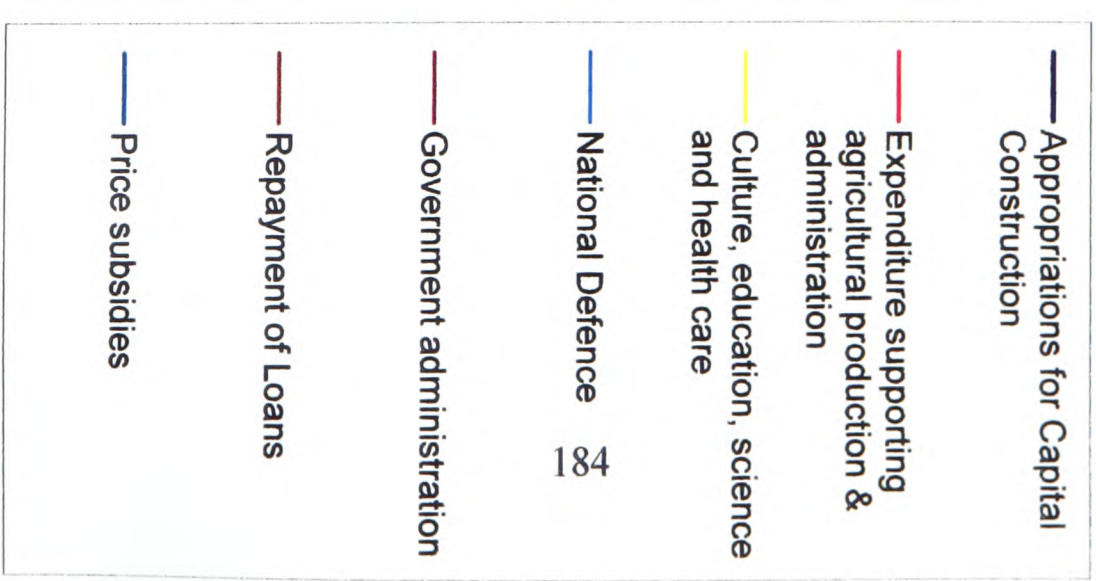
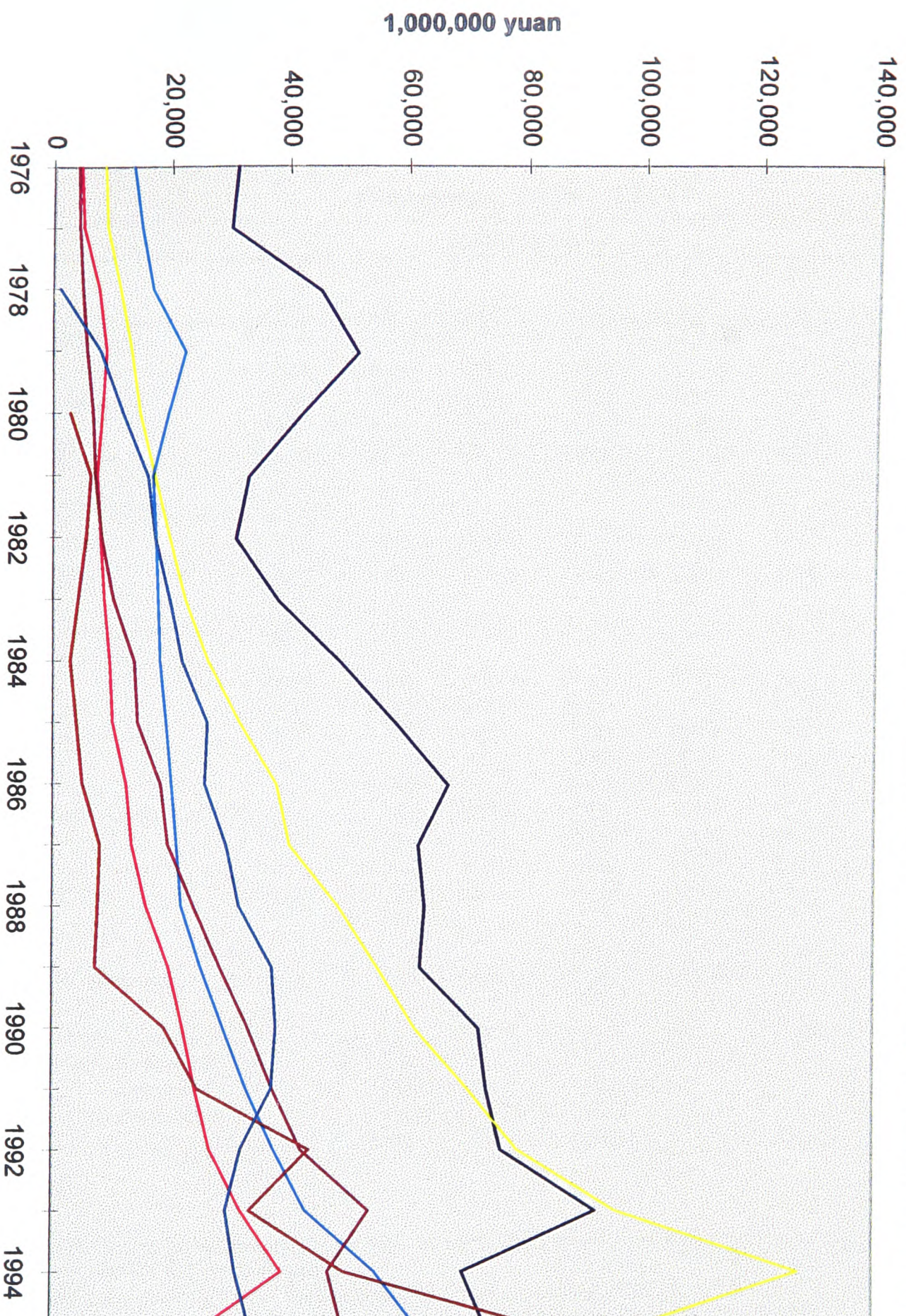
**Graph 4- Annual Distribution in Government Expenditure Items
1976 - 1991**



Source: China Statistical Yearbook 1992, p.195

- Price subsidies
- Repayment of Loans
- Government administration
- National Defence
- Pensions and social welfare relief funds
- Culture, education, science and health care
- Expenditure supporting agricultural production & administration
- Administration expenses of industry, transportation, commerce departments
- Geological prospecting
- Technical Updating, transformation of enterprises, new product trial funds
- Circulation Funds
- Appropriations for Capital Construction

Graph 5 - Growth In Selected Government Expenditure Items 1976 - 1995*



Source: see table 4

Table 5 - Government Budget and Unfinanced Deficit by Western Accounting Principles, 1978 - 1995*

1,000,000 yuan								
	1978	1982	1986*	1990	1992	1993	1994	1995*
REVENUE								
Taxes	51,928	70,002	209,073	282,186	312,160	402,810	479,800	533,700
Revenue from enterprises	57,199	29,647	4,204	7,830	6,000	5,430	?*****	?
**Other	2,985	4,362	15,695	43,074	47,220	53,130	?	?
TOTAL	112,110	104,014	179,727	235,827	392,840	482,558	618,300	652,300
EXPENDITURE								
Capital Construction	45,192	30,915	67,182	72,569	76,480	92,710	70,000	74,500
Technical Updating	6,324	6,902	12,985	15,391	22,360	42,360	46,761	(a)*****
Expenditure Supporting Agriculture	7,695	7,988	12,430	22,176	26,900	32,190	39,300	24,400
Culture, Education, Science and Health Care	11,266	19,696	37,993	61,729	79,300	96,050	127,400	96,400
National defence	16,784	17,365	20,075	29,031	37,790	43,250	55,100	63,100
Government Administration	4,909	8,160	18,243	33,347	42,460	54,030	47,200	49,900
Price Subsidies			25,748	38,080	32,160	29,620	31,300	34,100
Repayment of Loans		5,552	5,016	19,040	43,860	33,740	49,800	87,100
Pensions and Social Relief Funds	1,891	2,143	3,558	5,504	6,650	7,520	9,506	(b)
x xOther	10,454	7,051	7,710	10,492	71,010	100,510	119,633	(c)
***Enterprise loss subsidies	1,114	17,222	32,478	57,888	44,500	41,250	36,300	39,900
TOTAL	111,100	115,330	265,558	403,108	483,470	573,230	682,100	806,100
Deficit/ Surplus	1,010	-11,316	-85,831	-167,281	-90,630	-90,672	-63,800	-153,700
****Financed Deficit / Surplus:			13,825	37,563	66,970	69,380		
a. Government Domestic Bonds and Treasury bills		4,383	6,251	19,724				153,742
b. Foreign loans		4,003	7,574	17,821				
Unfinanced deficit / surplus		-2,930	-72,006	-129,736	-23,660	-21,292		

* Since 1985 a different accounting method has been used, this is especially reflected in the item 'Tax' revenues. 1995 lists official expected estimates.

** The item 'Other Expenditures' = 'Circulation Funds', 'Geological prospecting', and 'Administration expenses on Industry, Transportation and Commerce departments' (China Statistical Yearbook 1992, p. 195)
The item 'Other Revenues' = 'Funds levied for Development of Energy industry, Transportation and Key Construction Projects' and 'Other Revenues' (China Statistical Yearbook 1992, p. 192)

*** This table treats enterprise loss as an expense, contrary to Chinese practise.

**** This item is treated as a revenue item in the Chinese practise.

***** These items we have been unable to trace.

***** (a)+(b)+(c)= 33,670

Source for 1978 - 1991 : China Statistical Yearbook 1992, p. 189,192, 195/196, 200

Source for 1992 - 1993 : A Statistical Survey of China 1994, p. 39

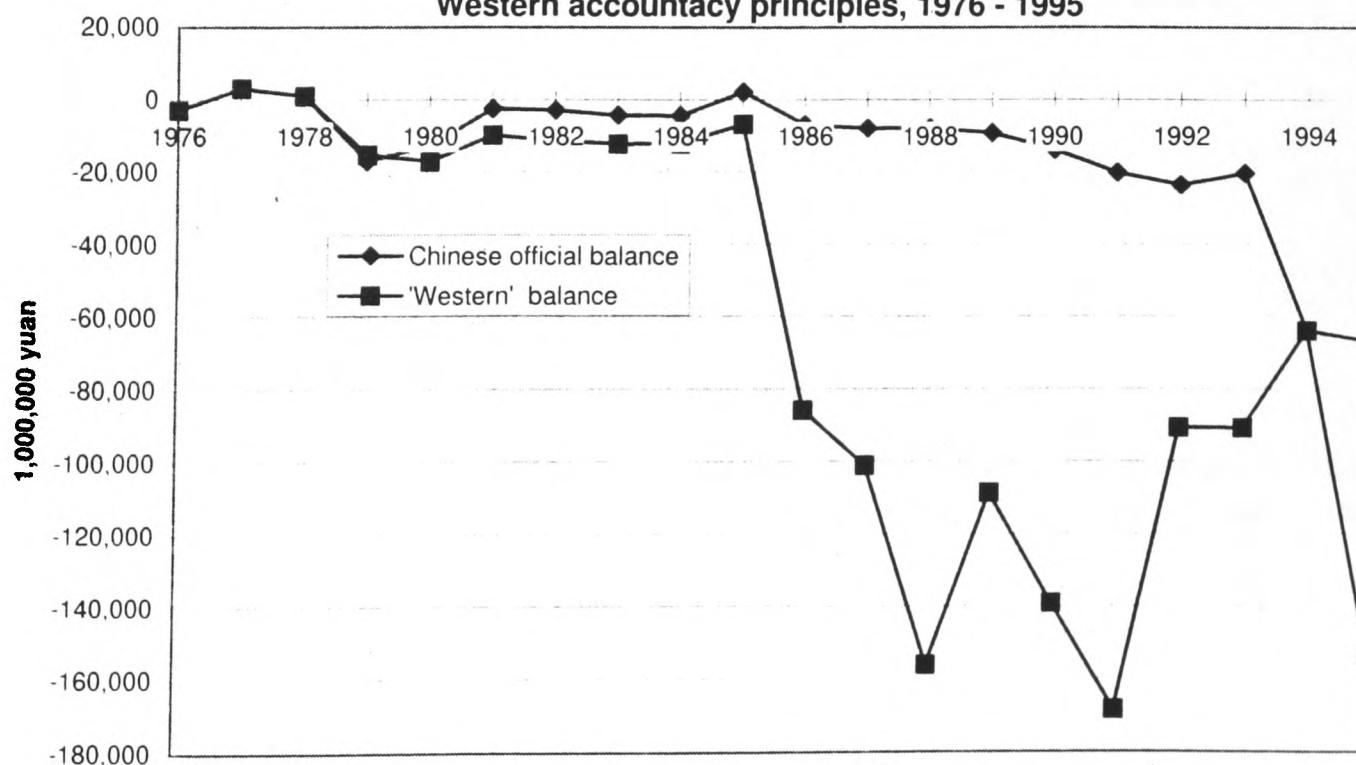
Source for 1994 - 1995 : Combination of Far Eastern Economic Review, 16 March 1995 and SWB 23 March 1995

(FE/2259 S1/4)

Table 6 - Comparison of Government budget deficit by Chinese - Western accountancy principles, 1976- 1995*

(1,000,000 yuan)							
Chinese accountancy principles				Western accountancy principles			
Year	Total Revenue	Total Expenditure	Chinese official balance	'Western' balance	Total Revenue	Total Expenditure	
1976	77,660	80,620	-2,960	-2,960	77,660	80,620	
1977	87,450	84,350	3,100	3,100	87,450	84,350	
1978	112,110	111,100	1,010	1,010	112,110	111,100	
1979	110,330	127,390	-17,060	-15,280	106,799	127,390	
1980	108,520	121,270	-12,750	-17,051	104,219	121,270	
1981	108,950	111,500	-2,550	-9,858	101,642	111,500	
1982	112,400	115,330	-2,930	-11,316	104,014	115,330	
1983	124,900	129,250	-4,350	-12,291	116,959	129,250	
1984	150,190	154,640	-4,450	-12,173	142,467	154,640	
1985	186,640	184,480	2,160	-6,825	177,655	184,480	
1986	226,030	233,080	-7,050	-85,831	179,727	265,558	
1987	236,030	244,850	-7,960	-101,061	181,432	282,493	
1988	262,800	270,660	-7,860	-156,210	191,076	348,666	
1989	294,790	304,020	-9,230	-108,701	206,605	315,306	
1990	331,260	345,220	-13,960	-139,182	235,827	403,108	
1991	361,090	381,360	-20,270	-168,458	263,926	432,384	
1992	415,310	438,970	-23,660	-90,630	392,840	483,470	
1993	511,480	531,980	-20,500	-90,672	482,558	573,230	
1994	518,175	581,976	-63,801	-63,800	618,300	682,100	
*1995	382,745	449,434	-66,680	-153,800	652,300	806,100	

Graph 6A - Comparison of the Government Budget Deficit by Chinese and Western accountancy principles, 1976 - 1995



Source 1979 - 1991: China Statistical Yearbook, 1992, p. 189, 200,203

Source 1992 - 1993 : A Statistical Survey of China, 1994, p. 39

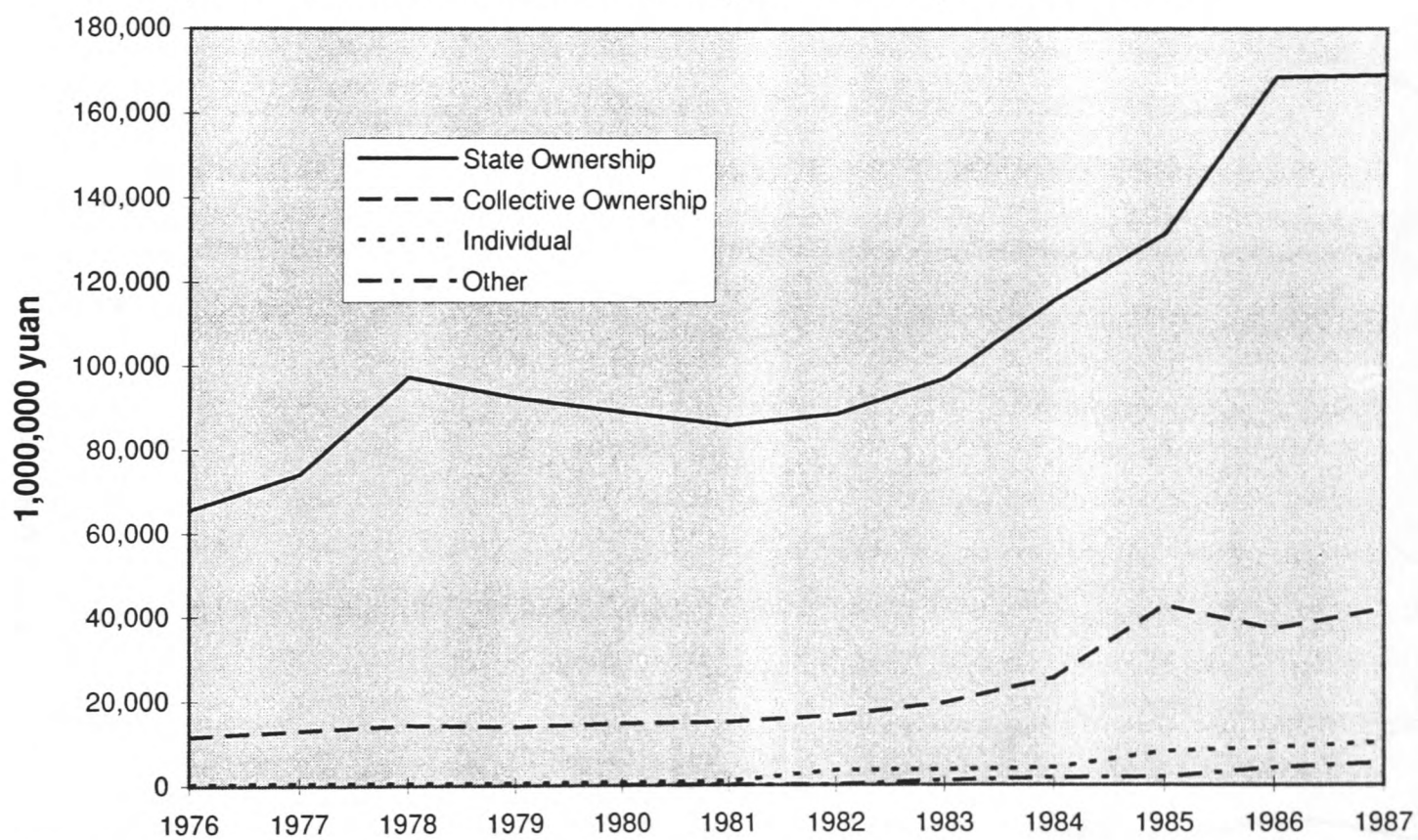
Source 1994-1995: Xinhua news agency domestic service, 20 March 1995 (SWB: FE/2259 S1/9, 23 March 95). the data for 1995 show the official planned estimates.

Table 7 - Government Revenue by Ownership 1979 - 1987

(1,000,000 yuan)

Year	State Ownership	Collective Ownership	Individual	Other	Total
1976	65,638	11,626	394		77,660
1977	73,996	12,987	463		87,450
1978	97,365	14,240	507		112,110
1979	92,362	13,904	530		110,330
1980	88,958	14,627	636	1	108,520
1981	85,805	14,946	884	3	108,950
1982	88,447	16,414	3,523	10	112,400
1983	96,985	19,441	3,575	1,115	124,900
1984	115,685	25,298	4,099	1,623	150,190
1985	131,481	42,465	7,959	1,811	186,640
1986	168,549	36,949	8,910	4,044	226,030
1987	169,025	41,707	10,161	5,349	236,030

Graph 7- Government Revenue by Ownership, 1976 - 1987



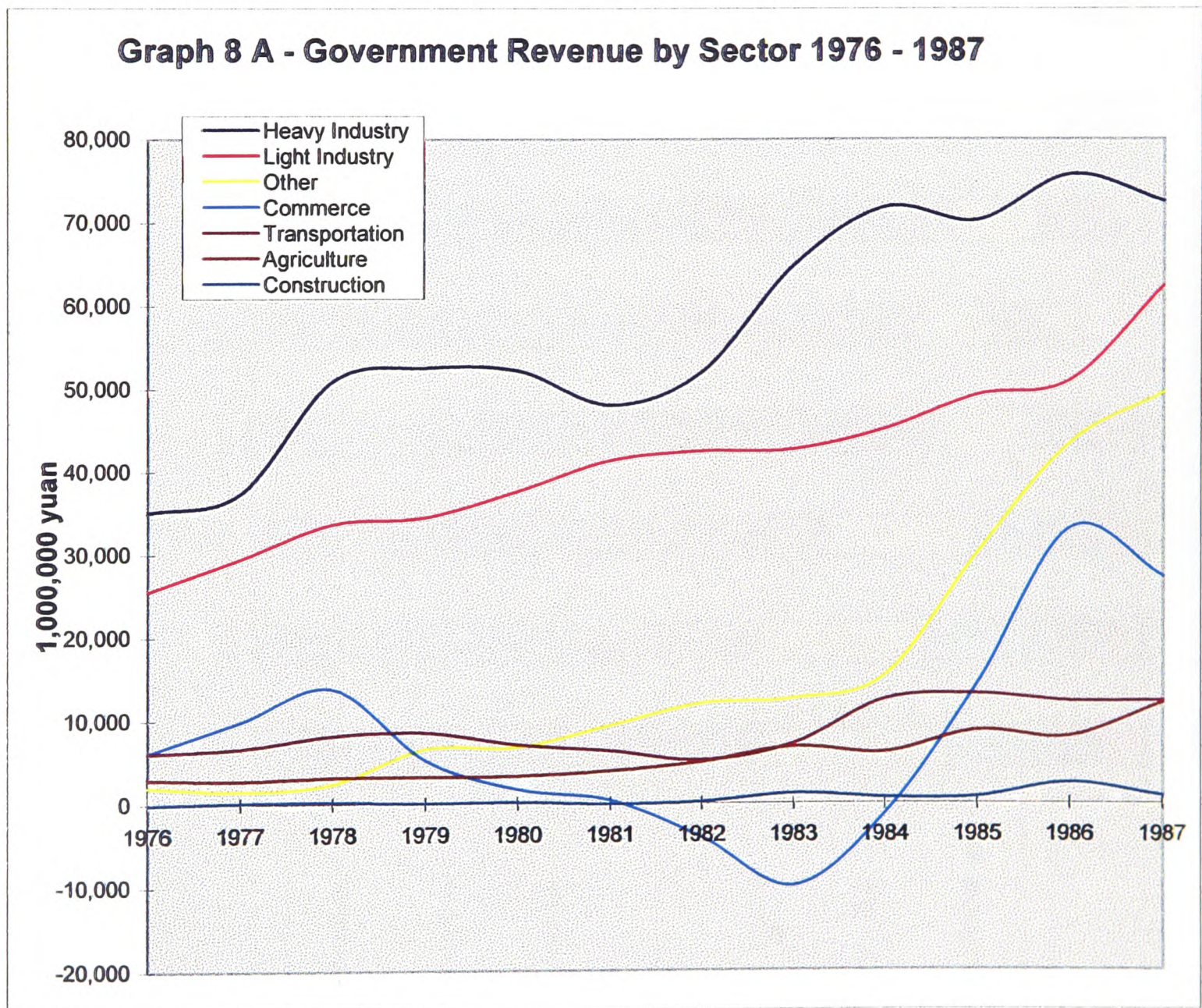
Source China Statistical Yearbook 1992, p.191

Table 8 - Government Revenue by Sector 1976 - 1987

(1,000,000 yuan)

Year	Heavy Industry	Light Industry	Other	Commerce	Transportation	Agriculture	Construction
1976	35,045	25,529	1,976	6,120	6,130	2,978	-110
1977	37,349	29,459	1,516	9,838	6,638	2,769	123
1978	50,890	33,617	2,392	13,709	8,150	3,165	189
1979	52,516	34,422	6,509	5,154	8,495	3,200	31
1980	52,158	37,577	6,693	1,647	7,034	3,311	103
1981	47,977	41,259	9,338	328	6,276	3,876	-108
1982	51,992	42,427	11,930	-4,183	5,154	4,932	145
1983	64,825	42,630	12,535	-9,931	7,118	6,757	1,147
1984	71,838	45,073	15,335	-1,254	12,447	6,107	640
1985	70,273	49,193	30,189	14,362	13,133	8,738	752
1986	75,787	50,973	43,388	33,122	12,277	8,037	2,442
1987	72,519	62,333	49,458	27,279	12,347	12,080	874

Graph 8 A - Government Revenue by Sector 1976 - 1987

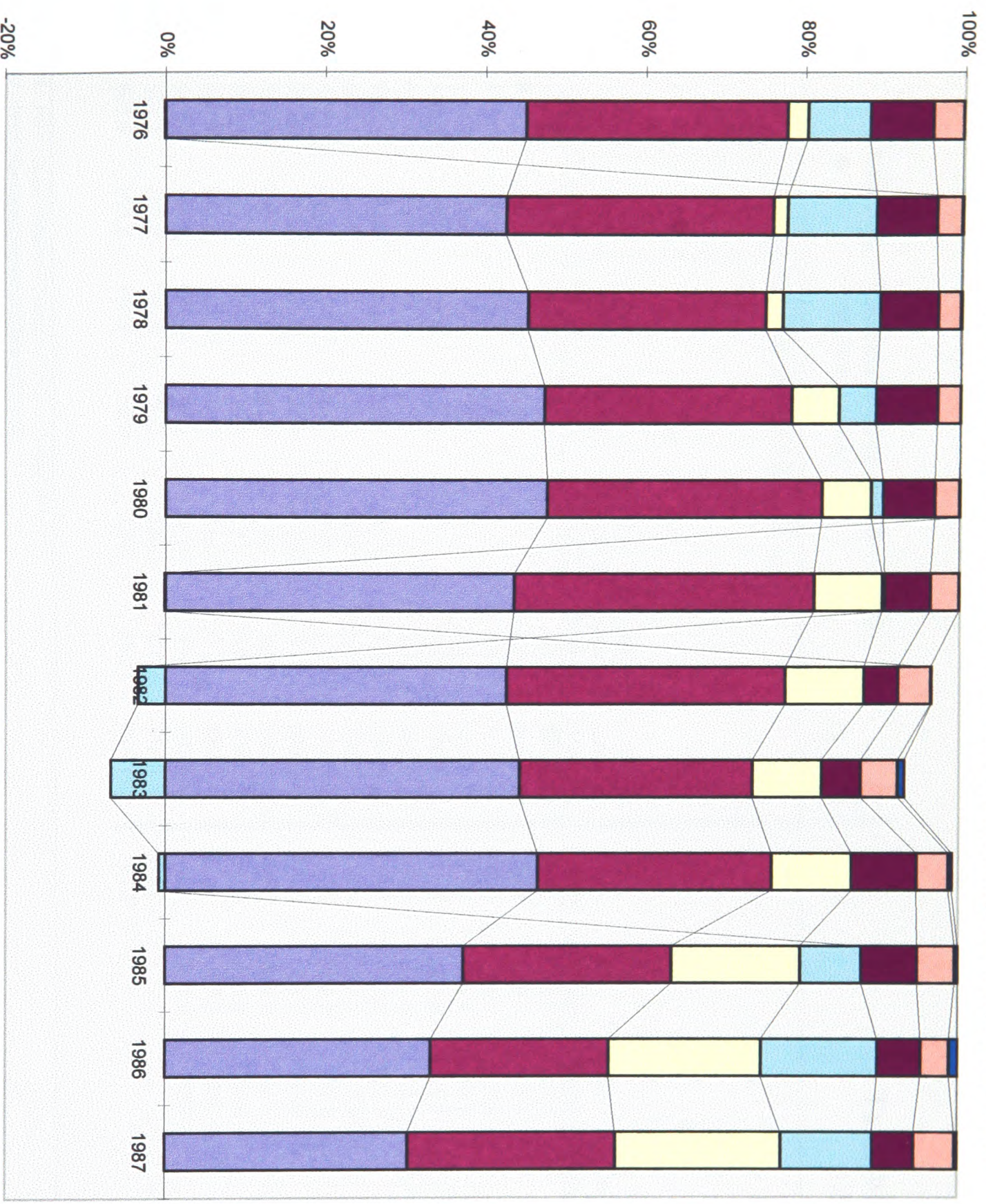


Source: China Statistical Yearbook 1992, p.190.

Note:- Total revenue for every sector includes taxes, depreciation funds, non-business revenue and funds for energy industry, transportation and key construction projects.

Total revenue for "Other" sectors includes government borrowing.

Graph 8 B - Government Revenue Distribution by Sector, 1976 - 1987



Source China Statistical Yearbook 1992, p. 190

Table 9A - Labour Force 1978 - 1993
(1,000,000 workers)

Year	Total	State / semi State Workers			Urban Individual Workers	Total Rural Labour
		State Owned Units*	Urban Collective Owned Units	Other Ownership Units**		
1978	401.5	95.0	74.5	20.5	0.2	306.4
1979	410.2	99.7	76.9	22.7	0.3	310.3
1980	423.6	104.4	80.2	24.3	0.8	318.4
1981	437.3	109.4	83.7	25.7	1.1	326.7
1982	453.0	112.8	86.3	26.5	1.5	338.7
1983	464.4	115.2	87.7	27.4	2.3	346.9
1984	482.0	118.9	86.4	32.2	3.4	359.7
1985	498.7	123.6	89.9	33.2	4.5	370.7
1986	512.8	128.1	93.3	34.2	4.8	379.9
1987	527.8	132.1	96.5	34.9	5.7	390.0
1988	543.3	136.1	99.8	35.3	6.6	400.7
1989	553.3	137.4	101.1	35.0	6.5	409.4
1990	567.4	140.6	103.5	35.5	6.7	420.1
1991	583.6	145.1	106.6	36.3	7.6	430.9
1992	594.3	147.9	108.9	36.2	8.4	438.0
1993	605.9	150.2	110.9	36.0	11.2	444.3

Table 9B - Rural Labour
(1,000,000 workers)

Year	Total Rural Labour	Agriculture	Rural industry	Rural Construction	Rural Transportation, postal & telecommunication services	Rural Commerce, Food Service, Material Supply & Marketing and Storage	Rural Other
1979	310.3	278.4	17.6	2.3	0.8	0.5	10.7
1980	318.4	283.3	19.4	2.8	0.9	0.7	11.2
1981	326.7	289.8	19.8	2.8	1.0	0.8	12.6
1982	338.7	300.6	20.7	3.8	1.2	0.8	11.6
1983	346.9	303.5	21.7	4.8	1.6	1.4	13.9
1984	359.7	300.8	25.5	8.1	3.2	3.0	19.1
1985	370.7	303.5	27.4	11.3	4.3	4.6	19.5
1986	379.9	304.7	31.4	13.1	5.1	5.3	20.4
1987	390.0	308.7	33.0	14.3	5.6	6.1	22.3
1988	400.7	314.6	34.1	15.3	6.1	6.6	24.1
1989	409.4	324.4	32.6	15.0	6.1	6.5	24.7
1990	420.1	333.4	32.3	15.2	6.4	6.9	25.9
1991	430.9	341.9	32.7	15.3	6.6	7.2	27.3
1992	438.0						
1993	444.3						

Source 1978 - 1991 : China Statistical Yearbook 1992, p. 79, 86, 294

Source 1992 - 1993: Statistical Survey of China 1994, p.22

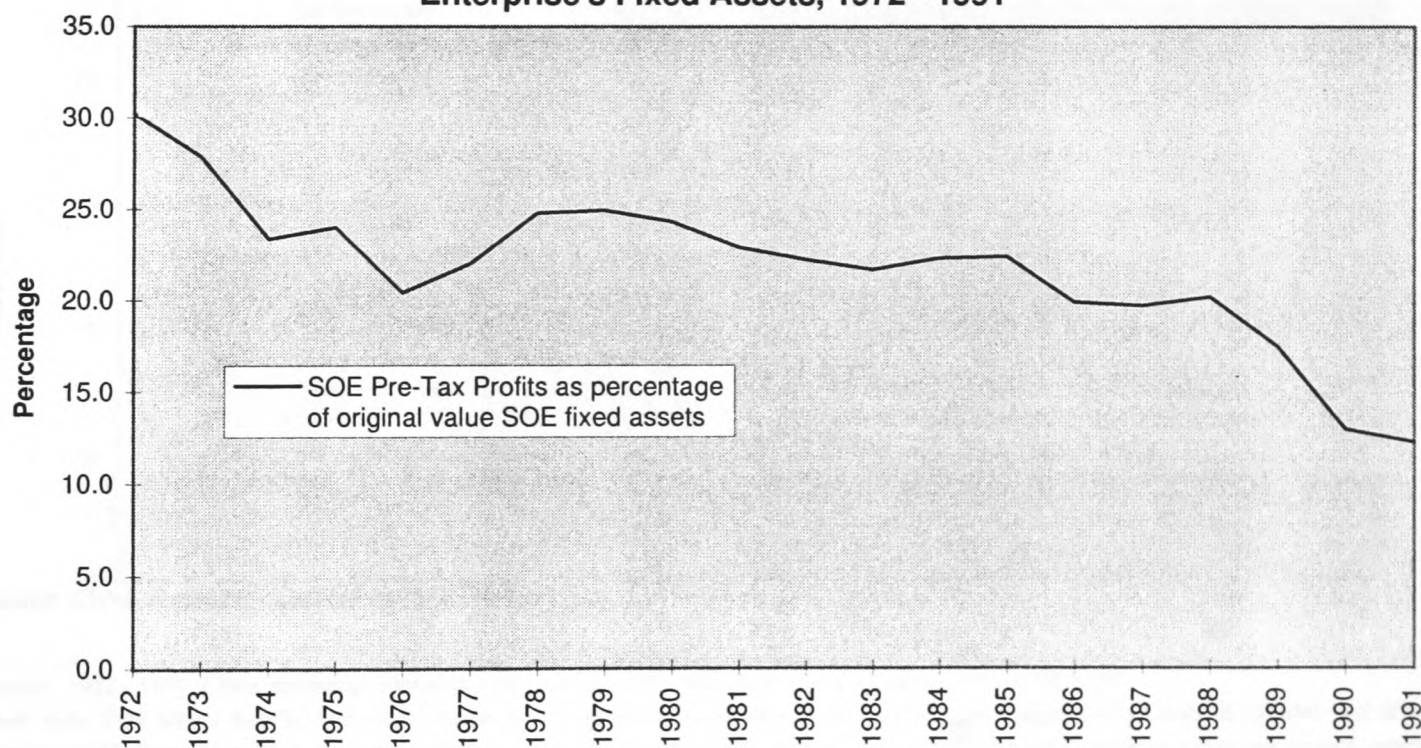
* State Owned Units : besides the wholly state owned enterprises, these units also include all government agencies

**Other Ownership Units : before 1983 this item was included in State Owned Units. It includes 'Joint Ownership units '=a. State and collectives, b.State and individuals, c. Collectives and individuals, d. Chinese and foreign investors, as well as 'Foreign Owned units' = a. Overseas Chinese, b. Foreign investors

Table 10 - Selected Financial and Cost Indicators for State Owned Enterprises, 1972 - 1993

Year	SOE losses (Million yuan)	SOE Profits (Million yuan)	SOE losses as percentage of SOE profits	SOE Pre-tax profits (Million yuan)	Original Value fixed assets (Million yuan)	SOE Pre-Tax Profits as percentage of original value SOE fixed assets
1972	3,225	35,510	9.1	54,620	180,690	30.2
1973	3,993	36,920	10.8	56,680	203,360	27.9
1974	6,177	31,630	19.5	51,270	219,610	23.3
1975	5,507	36,630	15.0	58,270	242,830	24.0
1976	7,687	31,710	24.2	53,550	262,180	20.4
1977	6,070	38,450	15.8	63,390	288,220	22.0
1978	4,206	50,880	8.3	79,070	319,340	24.8
1979	3,638	56,280	6.5	86,440	346,670	24.9
1980	3,430	58,540	5.9	90,710	373,010	24.3
1981	4,596	57,970	7.9	92,330	403,230	22.9
1982	4,757	59,770	8.0	97,220	437,500	22.2
1983	3,211	64,090	5.0	103,280	476,780	21.7
1984	2,661	70,620	3.8	115,280	517,000	22.3
1985	3,244	73,820	4.4	133,410	595,620	22.4
1986	5,449	68,990	7.9	134,140	674,480	19.9
1987	6,104	78,700	7.8	151,410	767,790	19.7
1988	8,192	89,190	9.2	177,490	879,520	20.2
1989	18,019	74,301	24.3	177,314	1,016,084	17.5
1990	34,876	38,811	89.9	150,314	1,161,027	12.9
1991	36,700	40,217	91.3	166,115	1,355,675	12.3
1992	36,900 (1)					
1993	45,300 (1)					

Graph 10 - State Owned Enterprise Pre-tax Profits to State Owned Enterprise's Fixed Assets, 1972 - 1991



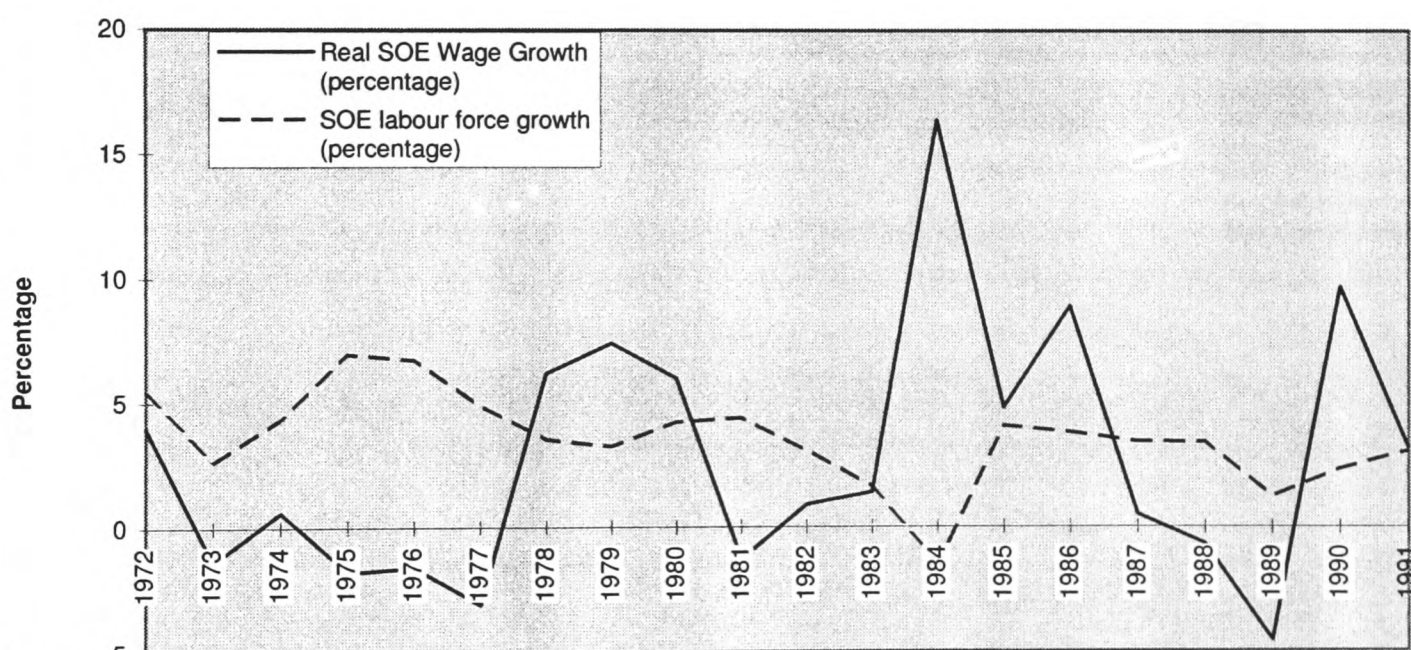
Source: 1972 - 1991: China Statistical Yearbook 1992. (1) Source 1992 - 1993: in Broadman, 1995, p. 12 from original source: 1994 Statistical Yearbook of China

Note: Item 'SOE losses' is listed as 'total loss of unprofitable enterprises on p. 385; 'SOE profits' as 'after tax-profits on p.385. Item 'SOE profit+taxes as % of ...' is listed on p.392. Note: Data are from independent accounting units only. They account for the bulk of the output, employment, assets, and profits of state industry.

Table 11 - Selected Financial and Cost Indicators for State Owned Enterprises, 1972 - 1993

Year	SOE labour force (million)	Real SOE Wage Growth (percentage)	SOE labour force growth (percentage)	Gross Output value of industry	Gross Output Value of SOE	SOE GOVI percentage of total GOVI	SOE pre-tax Profits as a percentage of total GOVI	SOE pre-tax profits as percentage to SEO GOVI
1972	56.1	4	5.5	256,500	217,717	84.9	21.3	25.1
1973	57.58	-1.4	2.6	279,400	234,752	84.0	20.3	24.1
1974	60.07	0.6	4.3	279,200	230,089	82.4	18.4	22.3
1975	64.26	-1.8	7.0	320,700	260,056	81.1	18.2	22.4
1976	68.6	-1.6	6.8	327,800	256,766	78.3	16.3	20.9
1977	71.96	-3.1	4.9	372,500	286,937	77.0	17.0	22.1
1978	74.51	6.2	3.5	423,700	328,918	77.6	18.7	24.0
1979	76.93	7.4	3.2	468,130	367,360	78.5	18.5	23.5
1980	80.19	6	4.2	515,426	391,560	76.0	17.6	23.2
1981	83.72	-1.3	4.4	539,978	403,710	74.8	17.1	22.9
1982	86.3	0.9	3.1	581,122	432,600	74.4	16.7	22.5
1983	87.71	1.4	1.6	646,044	473,940	73.4	16.0	21.8
1984	86.37	16.4	-1.5	761,730	526,270	69.1	15.1	21.9
1985	89.9	4.8	4.1	971,647	630,212	64.9	13.7	21.2
1986	93.33	8.9	3.8	1,119,426	697,112	62.3	12.0	19.2
1987	96.54	0.5	3.4	1,381,299	825,009	59.7	11.0	18.4
1988	99.84	-0.7	3.4	1,822,458	1,035,128	56.8	9.7	17.1
1989	101.08	-4.6	1.2	2,201,706	1,234,291	56.1	8.1	14.4
1990	103.46	9.7	2.4	2,392,436	1,306,375	54.6	6.3	11.5
1991	106.64	3.2	3.1	2,824,801	1,495,458	52.9	5.9	11.1
1992	108.89		2.1	3,706,571	1,782,415	48.1		
1993	110.94		1.9	5,269,199	2,272,467	43.1		

Graph 11 - Wage and Employment growth in State Owned Industry ,1972 - 1991



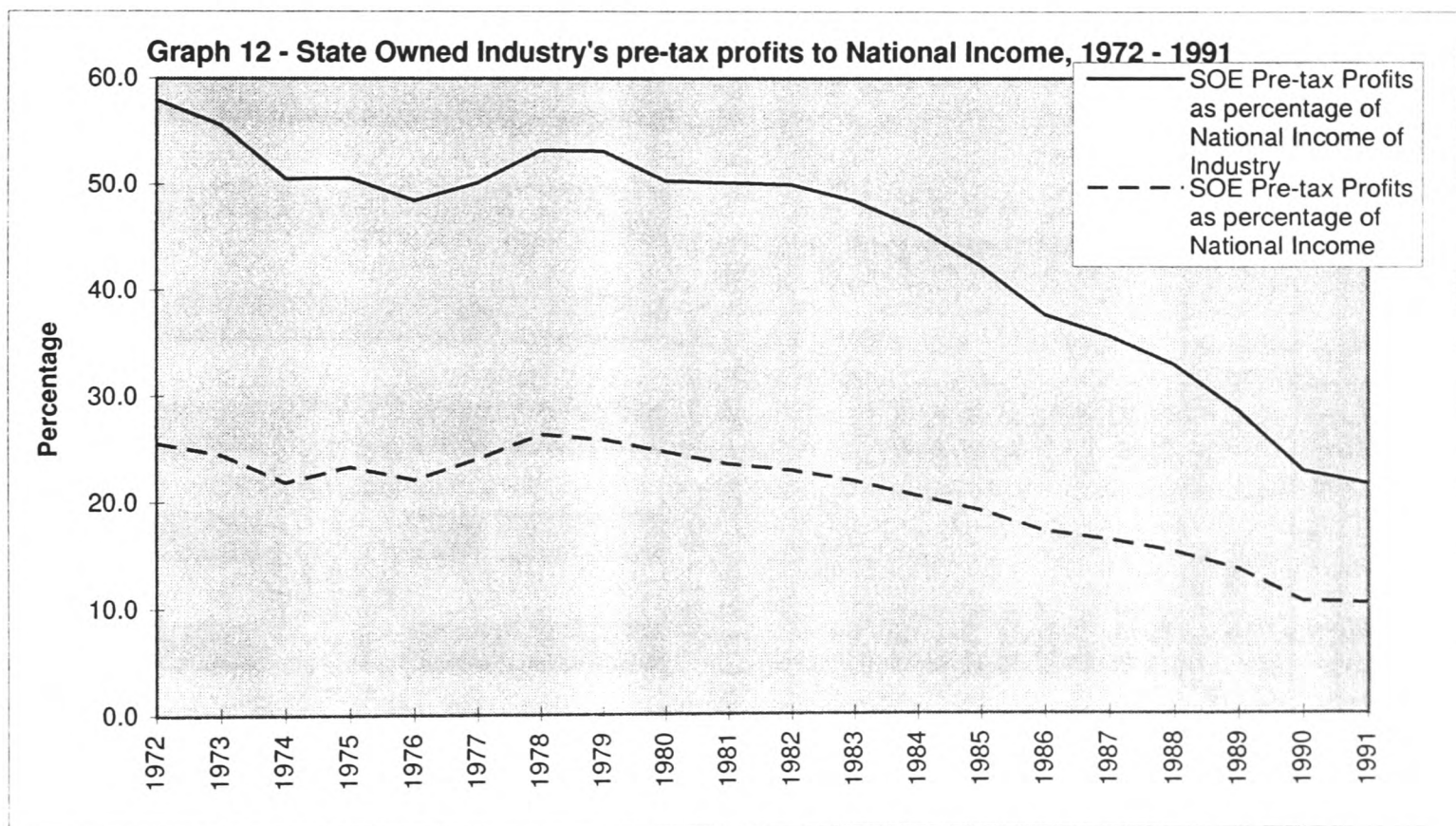
Source: China Statistical Yearbook 1992, p.79, 112

Source: 1972 - 1991: China Statistical Yearbook 1992; 1992 - 1993: Statistical Survey of China 1994, p.20, p. 74

Note: Item 'SOE labour force' is listed on p.79; item 'Real Wage growth' is listed on p.112; Items 'Gross Output value of Industry (GOVI) and SOE', are listed on p.368. Remaining items have been adapted. *Gross Output Value* is the sum of output value (list price * quantity produced) of each enterprise in given sector. The value of intermediate goods is double counted. *National Income* does not double count (=GDP).

Table 12 - National Income and State Owned Enterprise Profits, 1972 - 1991

Year	National Income in Industry (Billion yuan, at current prices)	National Income (Billion yuan, at current prices)	SOE Pre-tax profits (Million yuan)	SOE Pre-tax Profits as percentage of National Income	SOE Pre-tax Profits as percentage of National Income of Industry
1972	94.2	214	54,620	25.6	58.0
1973	102	232	56,680	24.5	55.6
1974	101.5	235	51,270	21.8	50.5
1975	115.2	250	58,270	23.3	50.6
1976	110.6	243	53,550	22.1	48.4
1977	126.5	264	63,390	24.0	50.1
1978	148.7	301	79,070	26.3	53.2
1979	162.8	335	86,440	25.8	53.1
1980	180.4	369	90,710	24.6	50.3
1981	184.4	394	92,330	23.4	50.1
1982	194.8	426	97,220	22.8	49.9
1983	213.6	474	103,280	21.8	48.4
1984	251.6	565	115,280	20.4	45.8
1985	316.3	702	133,410	19.0	42.2
1986	357.3	786	134,140	17.1	37.5
1987	426.2	931	151,410	16.3	35.5
1988	541.6	1,174	177,490	15.1	32.8
1989	624.1	1,318	177,314	13.5	28.4
1990	661	1,438	150,314	10.5	22.7
1991	770.3	1,612	166,115	10.3	21.6
1992		2,022			
1993		2,488			



Source: China Statistical Yearbook 1992, p. 29.

Note: 'Net Output Value' is the sum of the value-added of each enterprise in a given sector. 'National Income' is the sum of Net Output Value of Agriculture, Industry, Transportation, Construction, and Commerce, the five material production sectors of the economy. Note that the coverage of National Income in Chinese statistics excludes the value added in "non-material production sectors". China's National Income is approximately equivalent to the UN' Net Material Product. Note that National Income does not double count.

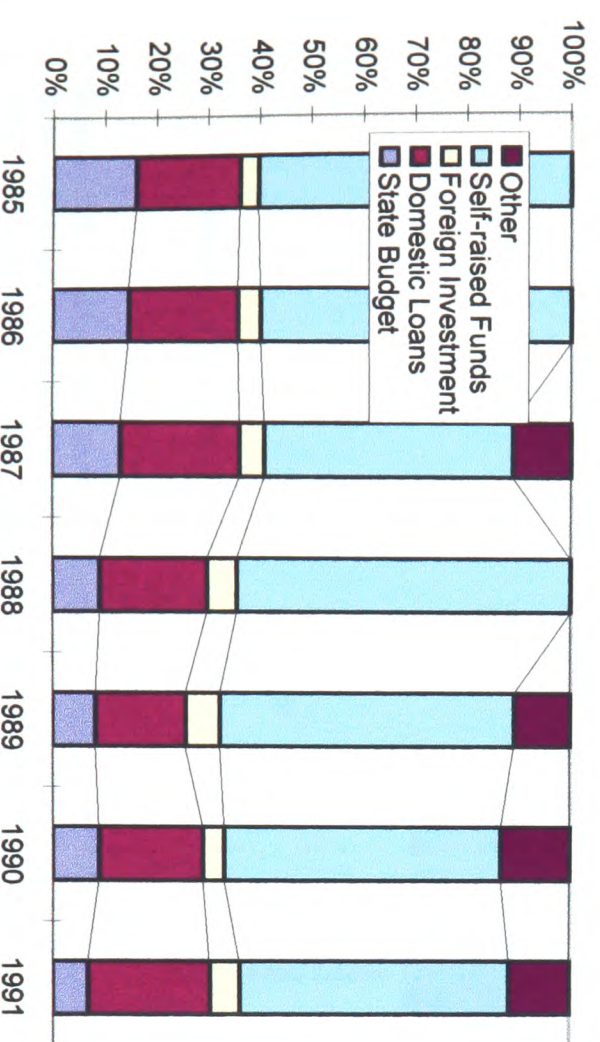
Table 13 A - Total Investment in Fixed Assets, by Source of Finance, 1985 - 1994

Year	(1,000,000 yuan)				
	State Budget	Domestic Loans	Foreign Investment	Self-raised Funds	Other
1985	40,780	51,027	9,148	153,364	
1986	44,100	63,800	13,200	180,900	
1987	47,554	83,594	17,537	174,518	40,883
1988	41,001	92,668	25,899	290,087	
1989	34,162	71,636	27,415	235,550	45,009
1990	38,765	87,088	17,826	232,949	58,301
1991	37,295	129,219	31,627	287,861	64,879
1992	33,400	215,200	46,000	491,000	
1993	46,400	292,600	90,700	816,100	
1994	53,000	370,300	176,900	1,036,800	

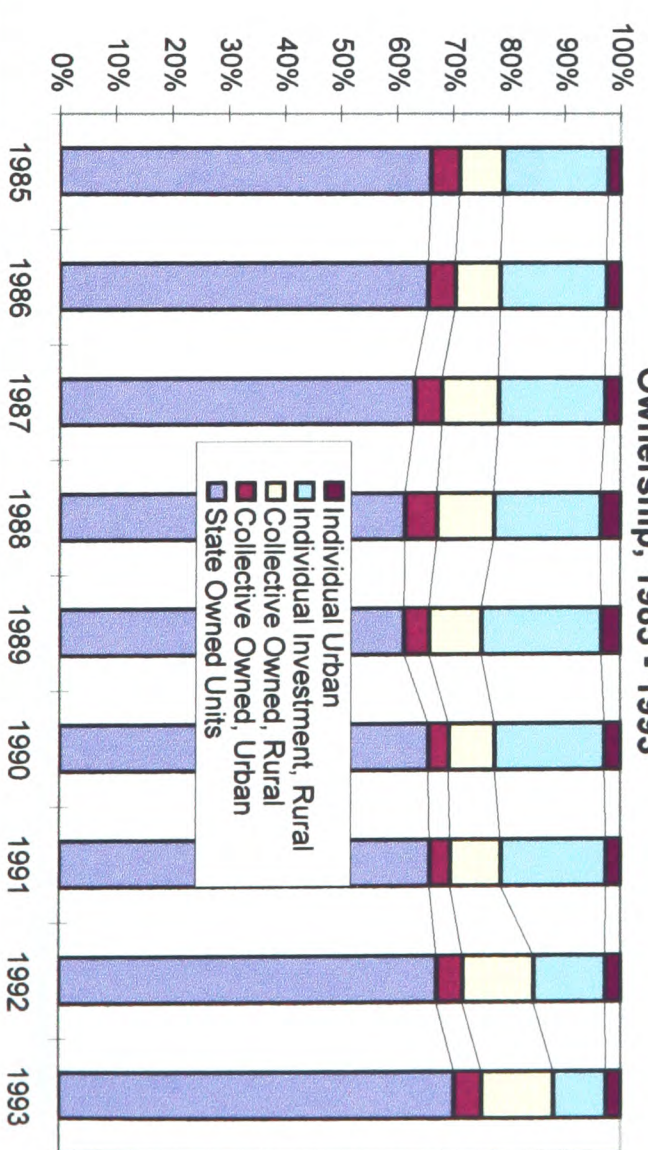
Table 13 B - Total Investment in Fixed Assets, by Ownership, 1985 - 1994

Year	(1,000,000 yuan)					
	Total	State Owned	Collective Owned, Urban	Collective Owned, Rural	Individual Investment, Rural	Individual Urban
1985	301,960	168,051	12,823	19,923	47,843	5,679
1986	364,090	197,900	14,600	24,500	57,500	7,500
1987	449,650	229,799	18,130	36,571	69,535	10,051
1988	413,770	276,276	25,497	45,674	86,523	15,685
1989	444,930	253,548	18,563	38,436	89,203	14,023
1990	550,880	291,864	16,338	36,610	87,647	12,470
1991	785,500	362,811	20,383	49,398	104,256	14,032
1992	1,182,910	527,360	36,450	99,490	100,550	21,650
1993	1,592,600	832,130	57,630	151,590	110,810	30,760
1994	1,592,600	1,135,400	275,800		181,400	

Graph 13 A - Composition of Investment in Fixed Assets, 1985 - 1991



Graph 13 B - Composition Investment in Fixed Assets by Ownership, 1985 - 1993

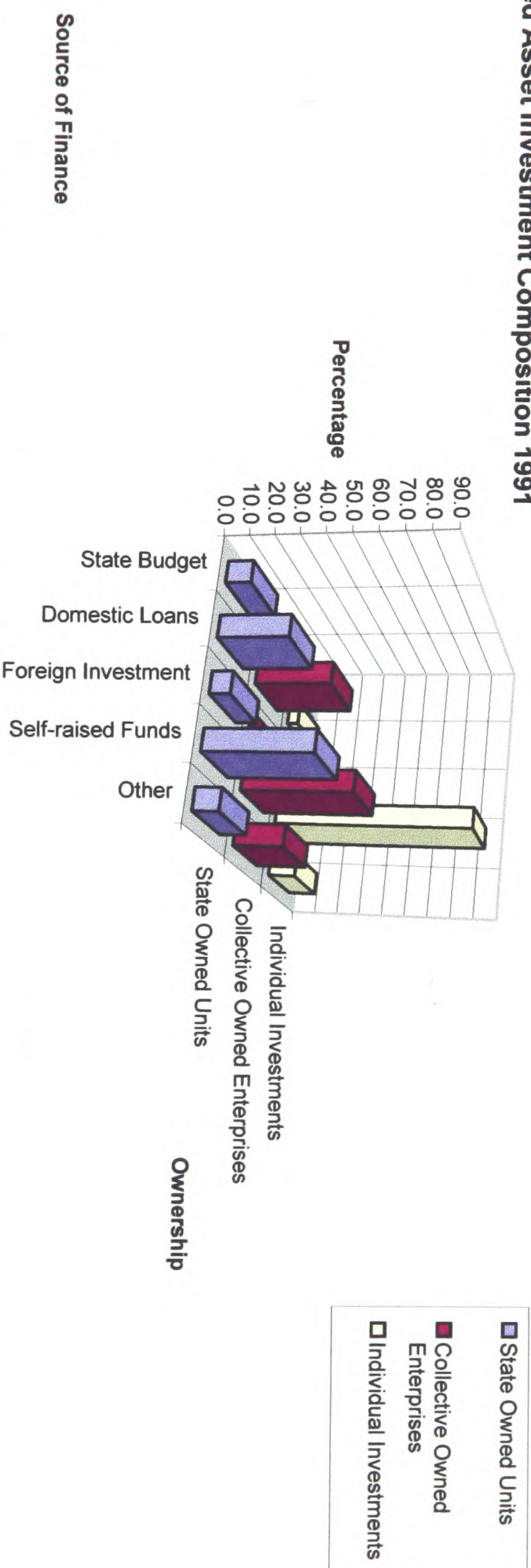


Source: 1985 - 1991: China Statistical Yearbook 1992, p. 125. Source 1992 - 1993: Table 13A - Economist Intelligence Unit p. 43; Table 13 B: Statistical Survey of China 1994, p. 27. Source 1994: Table 13A -

Table 13 C - 1991 Total Investment in Fixed Assets, by Ownership

	In percentages		Collective Owned		Individual Investments
	1991	1992	Enterprises 1991	Enterprises 1991	1991
State Budget	10.2	6.3	0.3		
Domestic Loans	28.1	30.4	31.7		4.5
Foreign Investment	8.3	8.0	2.0		
Self-raised Funds	43.1	46.6	45.8		84.1
Other	10.3	8.7	20.3		11.4

Graph 13 C - Fixed Asset Investment Composition 1991



Source 1985 - 1991: China Statistical Yearbook 1992, p.126, 127. Source 1992: Statistical Survey of China 1994, p. 28
 Note: Investment figures are the total of investment in productive (60-64%) and non-productive construction (35-40%). Figures for 1991 indicate that most Individual Investment goes towards housing: 23.5% in productive construction and 72.8% in housing.

Table 14 A - Regional diversity in Agriculture Gross Output Value, 1991 - 1993

Region	Total	Total Population		Gross Agricultural Output Value*		Gross Agricultural Output Value per Capita*		Average Growth in per Capita Gross Agricultural Output* in percentage 1991 - 1993
		(1,000,000)		(1,000,000 yuan)		yuan		
		1991	1993**	1991	1993	1991	1993	
	Total	1158.23	1185.17	815,703	1,099,364	704	928	31.76
Coastal	Beijing	10.94	11.19	7,647	10,047	699	898	28.43
	Tianjin	9.09	9.30	5,805	7,062	639	759	18.92
	Hebei	62.20	63.63	37,764	51,129	607	804	32.35
	Liaoning	39.90	40.82	30,228	44,270	758	1,085	43.16
	Shanghai	13.40	13.71	7,365	9,491	550	692	25.97
	Jiangsu	68.44	70.01	58,093	87,537	849	1,250	47.30
	Zhejiang	42.00	42.97	36,864	49,970	878	1,163	32.50
	Fujian	30.79	31.50	25,674	39,526	834	1,255	50.49
	Shandong	85.70	87.67	79,304	99,425	925	1,134	22.55
	Guandong	64.39	65.87	65,482	89,903	1017	1,365	34.21
	Guangxi	43.24	44.23	27,815	39,011	643	882	37.10
	Heinan	6.74	6.90	7,578	12,025	1124	1,744	55.12
	Total	476.83	487.80	389,619	539,396	817	1,106	35.33
Central	Shanxi	29.42	30.10	11,297	15,534	384	516	34.41
	Inner Mongolia	21.84	22.34	16,408	22,080	751	988	31.54
	Jilin	25.09	25.67	18,838	24,395	751	950	26.59
	Heilongjiang	35.75	36.57	24,771	33,060	693	904	30.46
	Anhui	57.61	58.94	31,726	51,912	551	881	59.95
	Jiangxi	38.65	39.54	27,155	36,011	703	911	29.63
	Henan	87.63	89.65	53,105	67,169	606	749	23.64
	Hubei	55.12	56.39	40,504	50,117	735	889	20.95
	Hunan	62.09	63.52	42,558	56,347	685	887	29.42
	Total	413.20	422.70	266,362	356,625	645	844	30.88
Western	Sichuan	108.97	111.48	68,013	87,637	624	786	25.96
	Guizhou	33.15	33.91	16,534	20,140	499	594	19.07
	Yunnan	37.82	38.69	22,293	28,121	589	727	23.31
	Tibet	2.26	2.31	2,089	2,245	924	971	5.05
	Shaanxi	33.63	34.40	18,537	25,049	551	728	32.09
	Gansu	22.85	23.38	10,836	14,042	474	601	26.67
	Qinghai	4.54	4.64	2,524	3,100	556	667	20.06
	Ningxia	4.80	4.91	2,695	3,189	561	649	15.67
	Xinjiang	15.55	15.91	16,201	19,820	1042	1,246	19.59
	Total	263.57	269.63	159,722	203,343	606	754	24.45

* Gross Agricultural Output is without Rural Industrial Output.

** Population data for 1993 are extrapolated from the 1993 annual growth figure of 2.3% and the regional population data of 1991.

Source 1978 - 1991: China Statistical Yearbook 1992, p. 298, p. 65

Source 1993: Statistical Survey of China 1994, p. 61

Table 14 B - Regional Disparity in Industrial Gross Output Value, 1991 - 1993

(1,000,000 yuan)

	Collective Enterprises			State Owned Enterprises			Individual Enterprises			
	1991	1993	Percentual growth	1991	1993	Percentual growth	1991	1993	Percentual growth	
NATIONAL TOTAL	1,008,475	1,305,052	29	1,495,458	2,330,690	56	160,910	411,454	156	347
Coastal										
Beijing	26,193	27,985	7	52,778	76,502	45	834	14,783	1,673	1,321
Tianjin	26,497	17,701	-33	43,643	65,311	50	953	15,726	1,550	1,691
Hebei	53,263	50,638	-5	63,814	105,192	65	13,859	6,323	-54	99
Liaoning	52,240	64,439	23	112,103	183,896	64	13,487	19,062	41	467
Shanghai	40,160	39,412	-2	126,313	173,671	37	150	82,004	54,569	5,982
Jiangsu	184,373	290,476	58	104,335	168,660	62	11,280	43,298	284	618
Zhejiang	109,781	154,220	40	53,093	82,563	56	12,168	18,611	53	433
Fujian	20,981	18,919	-10	26,869	42,015	56	3,923	33,430	752	1,061
Shandong	133,268	161,395	21	103,869	171,719	65	20,350	9,807	-52	112
Guandong	82,868	116,709	41	97,359	159,560	64	11,896	138,693	1,066	2,106
Guangxi	8,745	15,706	80	30,007	53,415	78	2,541	1,863	-27	42
Heinan	499	558	12	4,029	7,956	97	239	1,664	596	241
Total	738,868	958,158	30	818,212	1,290,460	58	91,680	385,264	320	790
Central										
Shanxi	19,327	18,674	-3	36,724	54,449	48	3,957	1,097	-72	36
Inner Mongolia	5,220	7,337	41	23,212	36,628	58	1,284	685	-47	316
Jilin	13,356	16,186	21	43,947	69,049	57	3,872	3,999	3	156
Heilongjiang	15,546	18,228	17	79,754	100,989	27	2,548	1,563	-39	43
Anhui	24,939	39,496	58	43,742	70,137	60	7,405	1,085	-85	18
Jiangxi	13,914	17,430	25	31,387	50,670	61	4,086	1,289	-68	33
Henan	41,278	43,127	4	64,989	103,287	59	15,090	2,860	-81	32
Hubei	35,710	44,070	23	71,756	118,428	65	4,912	4,033	-18	72
Hunan	23,504	31,689	35	50,436	76,595	52	5,971	1,903	-68	30
Total	192,794	236,237	23	445,947	680,232	53	49,125	18,514	-62	44
Western										
Sichuan	41,163	67,716	65	89,821	140,642	57	11,163	4,255	-62	38
Guizhou	3,308	4,611	39	18,864	27,241	44	1,990	621	-69	18
Yunnan	8,068	9,825	22	30,045	51,333	71	1,041	364	-65	9
Tibet	40			287			13			0
Shaanxi	11,440	11,088	-3	34,864	51,311	47	3,759	1,629	-57	47
Gansu	5,563	7,547	36	24,541	36,596	49	1,290	141	-89	6
Qinghai	828	1,081	31	5,078	7,827	54	142			0
Ningxia	1,177	1,678	43	5,770	9,406	63	279	190	-32	39
Xinjiang	5,225	7,051	35	22,071	35,243	60	430	576	34	36
Total	76,812	110,597	44	231,341	324,356	40	20,107	7,776	-61	29

Source: Statistical Survey of China 1994, p. 75

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