

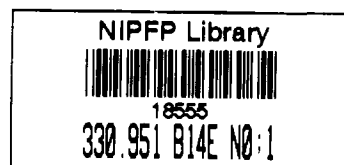
ECONOMIC REFORMS IN CHINA AND THEIR IMPACT
AN OVERVIEW

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ECONOMIC REFORMS IN CHINA AND THEIR IMPACT

An Overview

by

Amaresh Bagchi

I. Introduction

"China turns to Marx to control economy," says the headline of a recent article in a US newspaper. Having won their way through crowds of resistance fighters by employing the People's Liberation Army, Premier Li Peng and his "hardline Leninist backers", says the article, have now drawn up an economic agenda which implies a large-scale reversal of many of the reforms which acknowledgedly had opened and invigorated the Chinese economy in the 1980s. The agenda reportedly envisages:

- Recentralisation of economic decision making, going back on the process of delegation to lower levels of government and to the enterprises;
 - New controls on the growth of China's "fledgling private businesses" and their supplies of raw material and equipment to help sluggish big State enterprises;
 - Bringing back controls on consumer prices and supplies of raw materials to State enterprises at fixed prices;
 - Denying direct access to foreign loans for enterprises or lower level governments;
 - Reinstating the State plan as the "key determinant" in the economy and de-emphasizing the role of the market and prices as economic regulators;
- and

- Mounting more vigorous campaign against corruption.¹

This obviously is an agenda "devised to wipe out some of the main reforms of the 1980s and to take life out of many others." Stern measures, it appears, have succeeded in slashing industrial growth which had been causing overheating, by nearly 50 per cent to a "more manageable 10.8 per cent" in the first half of the current year.

A report datelined Beijing July 30 however said that despite recent sanctions by Western countries, China will continue its open door economic policy and not return to the Soviet bloc, although it will not allow other countries to use loans to interfere in the internal affairs of China.² There were several other earlier reports which seemed to indicate that the Tiananmen Square incidents would not be allowed to reverse the course on which the post-Mao rulers had set the economy of China.

Whether the problems encountered by the Chinese economy in the wake of the reforms initiated by the Eleventh Central Committee of the Chinese Communist Party in December 1978 - inflation, corruption, mounting foreign debt, etc. - would force a complete turnabout in economic policy had been a matter for intense speculation among China watchers even before the convulsions of May-June this year. There were many indications of brakes being applied on several fronts in the country's economy since at least the second half of 1988, when inflation was running at more than 20 per cent. Stiff austerity measures aimed at cooling China's overheated economy were announced even in March 1989, even though these might result in huge new losses to the already heavily subsidized State-owned enterprises. It was necessary, said the country's chief economic planner, Yao Yilin, announcing these measures, for the Central government to regain its grip over the economy in order "to readjust the economy and overcome the difficulties."³ Under

these measures, some construction projects in key sectors including energy, transport and raw materials which were formerly exempted from slowdown were to be terminated. The measures now announced seem to go further.

Do these trends portend total rejection of the reforms initiated over the last one decade and restoration of the earlier Soviet-type planning with centralised control over production and distribution? Or are they meant only to tackle the immediate problems caused by the extra-rapid growth of the economy in the wake of the reforms before going further ahead? These questions are obviously of more than academic interest to the rest of the world, especially for countries in the neighbourhood of China. This paper seeks to provide briefly an overview of the economic reform of the 1980s in China, its distinguishing characteristics and impact, analyse its strengths and weaknesses and speculate about possible future course in the light of available studies and evidence.

II. Reforms of the 1980s - Course and Characteristics

As is well known by now, the post-Mao economic reform in China was marked by three distinct phases. The first and apparently the most fruitful phase covering roughly the six years from December 1978 to October 1984, saw a complete overhaul of the production system in agriculture with the abolition of the communes (and its appendages, the brigades and the production teams) and the introduction of family farming with contract responsibility to the State, coupled with upward revision of agricultural prices. In the second phase which commenced in 1984, the reform was extended to enterprises in the urban areas, the aim being to initiate radical changes in the "micro-economic" system - "the system of production, circulation and social distribution along with planning, finance, taxation, prices, wages, foreign trade and materials supply." The keynote of enterprise reform was separation of ownership from

management and granting autonomy to enterprises in several areas of decision making and induction of contract responsibility system in place of the earlier practice of handing in all profits to the State. Concomitantly, many enterprises were transferred to local governments. Commercial banking functions which were so far handled largely by the People's Bank of China were also transferred to newly created financial institutions. Enthused by the results achieved, in 1987 the Party's Thirteenth National Congress resolved to reform the political system and set the country on a new period of all-round reform embracing politics, economics, science, education and culture, marking a third phase in the progress of the reforms.*

The three key elements of the reforms were (i) greater decentralisation; (ii) ushering in of market forces and material incentives to guide micro-economic decision making in both industry and agriculture; and (iii) opening the economy to the outside world. The aim was to mould China's economy which was said to be still in a state of primitive socialism into a "planned commodity economy". While the thrust towards decentralisation was not new in communist China - Mao himself had attempted decentralisation from time to time, and particularly in 1956-58 - what distinguished the present reforms was that unlike in the past when the focus was on *administrative* decentralisation, the accent this time was on giving more freedom and incentive to producers in all fields, and expanding the powers and autonomy of State enterprises. Another distinguishing feature of the post-Mao reforms is its comprehensive scope embracing a wide field extending from productive relations in agriculture to enterprise management and ownership and contraction of the area of centralised control, to foreign economic relations marked by a dramatic opening up to the outside world.

III. Impact

a. Output growth acceleration

From all account, the results of the reform have been spectacular. An economy which had been showing all signs of stagnation picked up momentum, visibly raising the living standards of the people both in towns and villages. The pre-reform period (1957-78) also had seen relatively good growth of output at 6 per cent per annum on an average which was higher than that of India and many other developing countries but that did not make a commensurate impact on the people's level of living. Per capita consumption of peasants had increased by only 1.5 per cent per annum while that of urban population by 2.5 per cent. A large proportion of the population had income below the average, which too was rising rather slowly. Overall, the economy had been operating at a low level of efficiency, which was sought to be made up by massive investment. Productivity in both industry and agriculture was either stagnating or declining. The reform of the 1980s did bring about a turnaround in all this.

In the decade 1979-88 growth of national income accelerated to 9.3 per cent from 6 per cent per annum in 1953-88. Growth rate of per capita income doubled with agricultural output growth increasing from 2.9 per cent in the earlier twenty-five years to 6.2 per cent (Table 1). Foreign trade also recorded even more impressive, four-fold growth.

Table 2 shows the GNP growth rates in China and selected Asian countries. Contrasting with a growth of 4 per cent in the 1960s and 5.8 per cent in the 1970s, Chinese economy recorded a growth of 9.9 per cent in 1980s, compared with an average of 3 per cent for developing countries and 4.7 per cent of India. After carefully sifting the evidence, even a discerning observer of China and India like Subramanian Swamy acknowledges that while the

output growth rates in India and China were not all that different in the period 1952-78, and there has been a sharp acceleration in growth in both India and China in the post-1978 period because of liberalisation and reform in both the countries, per capita income growth has been decisively higher in China after 1978.²

TABLE 1

Growth of National Income, Agricultural and
Industrial Production of China

(Average year-to-year per cent change)

	1953-78	1979-88	1979-84	1985-88
National income	6.0	9.3	8.3	10.7
National income per capita	3.9	7.8	6.9	9.3
Agricultural output	2.9	6.2	7.7	3.9
Industrial production	11.3	12.8	9.6	17.8
Light industry	9.3	14.9	12.3	19.0
Heavy industry	13.8	10.9	7.2	16.6

Sources: State Statistical Bureau,
1988 Statistical Yearbook
of China.

Bank of Japan, Special
Paper No. 176.

TABLE 2

Growth of GNP (Real) in China and Selected Asian Countries

	(Per cent per annum)		
	1960s	1970s	1980s upto 1988)
China	4.0	5.8	9.9
Republic of Korea	8.4	8.0	9.3
Thailand	7.9	6.9	5.6
Developing Countries	5.6	5.3	3.0
India*	3.7	3.2	4.7

* Economic Survey

Source: Bank of Japan, Special
Paper No. 176.

b. Agricultural growth

Acceleration in China's output growth rate in the post-reform period occurred largely from a sharp rise in the growth rate of agricultural output from 2.9 per cent to 6.2 per cent (Table 1). This was in sharp contrast with the sources of growth in the earlier period (1952-78) when it was industry which had grown at about 11 per cent as compared to less than 3 per cent in agriculture. The acceleration in agricultural output growth brought to an end the virtual stagnation in the level of consumption of some of the essential commodities which China was experiencing in the Seventies.

Despite an overall growth of the economy at 6 per cent a year, per capita consumption of grains in China in 1978 was lower than that in 1957 by 3.7 per cent and of edible vegetable oils by more than 30 per cent.⁴ For a sizeable proportion of the population per capita income was below the average which was already very low and was not rising rapidly. With the introduction of family farming system and greater incentives permitting those who could produce above the fixed contract to retain and sell the excess in the open market and also allowing greater freedom in deciding what to produce, and raising market prices for most farm products, foodgrains production soared to 407 million tonnes in 1984 from 304 m. tonnes in 1978 (Table 3). Imports of agricultural products were significantly reduced, rationing of basic

TABLE 3

Foodgrains Output in China
(million metric tons)

Year	Output	Annual change (Per cent)
1951	143	-
1955	184	8.2
1960	158	-10.7
1965	195	-5.8
1970	247	9.3
1975	280	1.8
1976	286	2.1
1977	283	-1.0
1978	304	7.4
1979	332	9.2
1980	321	-3.3
1981	325	1.2
1982	353	8.6
1983	387	9.6
1984	407	5.2
1985	379	-6.9
1986	391	3.2
1987	402	2.8
1988	394	-2.0

Source: *Economic Growth in China and India : A Perspective by Comparison* by Subramanian Swamy.

foodstuffs in the cities was eliminated and the variety and quality of diet improved. The rise in the level of per capita consumption of key commodities after 1978 is shown by the following figures:⁷

	<u>1952</u>	<u>1978</u>	<u>1987</u>
Grains (Kgs.)	198	195	251
Meat (Kgs.)	7.9	8.9	17.7
Cloth (Metres)	5.7	8.0	11.3
Bicycles (Units per 100 people)	0.06	0.85	3.35

A striking feature of the agricultural growth in the post-1978 reform period is the contribution of production of cash crops (non-grain items) and animal husbandry (Table 4). Whereas, earlier, the growth in

TABLE 4
The Composition of Agricultural Output Growth
(Based on 1980 constant prices)

	<u>1971-78</u>	<u>1980-82</u>	<u>1982-86</u>
<i>A. Growth Rates (in percentage per year)</i>			
Gross value of agricultural output	4.3	7.5	13.0
Crops	2.7	5.6	4.2
Grain	2.9	3.9	2.5
Non-grain	2.1	13.2	9.4
Animal husbandry	2.6	10.1	10.1
Subsidiary output	17.9	13.7	40.0
Village industry	23.5	14.8	43.1
<i>B. Share in Total Output Growth (in percentage)</i>			
Gross value of agricultural output	100.0	100.0	100.0
Crops	45.8	49.2	17.8
Grain	39.6	27.1	7.9
Non-grain	6.3	22.1	9.8
Animal husbandry	9.1	19.7	11.5
Subsidiary	34.5	25.5	66.3
Village industry	27.2	19.5	58.7
Forestry and fisheries	10.6	5.6	4.4

Source: 'Reforming China's Economic System' by Dwight H. Perkins, *Journal of Economic Literature*, June 1988.

agriculture came mainly from grains and subsidiary output like small-scale industrial production (Chinese statistics on agricultural production include these), in the reform period, the impetus was provided more by non-foodgrains output and more particularly rural industry.

The impetus for extending the reform to a wider field came from the evident success of the new strategy in agriculture. The initial results were not as impressive in industry as in agriculture. Nevertheless, greater freedom to enterprises to produce goods in demand, get rid of unsold stocks and invest retained funds, led to a rapid rise of industrial production which became the dominant growth sector again. As Table 1 shows, industrial production growth shot up to 17.8 per cent during 1985-88, giving rise to overheating and the associated problems.

c. Impact on structure of economy

One of the dramatic results of the reform has been the change in the structure of the Chinese economy with services sector (comprising finance, trade and consumer services like housing, entertainment, education and restaurants) regaining the ground it had lost in the 1960s and 1970s. The changes in the structure of the economy can be seen from Table 5. There has been a rapid growth of housing activities, and financial facilities for individuals cooperative enterprises and also government agencies. Foreign investment and technology were invited with encouragement for foreign entrepreneurs and banks to engage in wholly owned or joint ventures.

TABLE 5

Structure of China's GDP

(Per cent)

	1952-65	1966-78	1979	1987
Agriculture	44.8	39.3	36.6	33.8
Industry	33.1	43.0	48.6	45.7
Services	22.1	17.7	14.8	20.4
of which				
Commerce	13.2	9.7	7.3	10.1
Transportation	4.5	3.8	3.6	3.7
Construction	4.4	4.2	3.9	6.6

Source: *Statistical Yearbook of
China, 1988.*

d. Foreign trade dependency

Both imports and exports have grown tremendously. From a paltry \$ 5 billion on an average in 1960-78 China's exports are now running at a level of nearly \$ 40 billion (Table 6). The volume of trade seems to be fast reaching almost the level of that of South Korea and Hong Kong. China's share in world trade has increased from less than 2 per cent to nearly 3.5 per cent (Table 7).

TABLE 6
Foreign Trade
(US\$ Billions)

Year	Exports	Rate of growth (%)	Imports	Rate of growth (%)	Balance	(Exports+ imports)/ national income (%)
Foreign Trade^a						
1952-65	1.61	7.4	1.57	4.3	+0.04	10
1966-78	4.72	11.5	4.64	12.9	+0.08	9
1979	13.66	40.1	15.67	43.9	-2.01	13.6
1980	18.27	33.8	19.55	24.8	-1.28	15.3
1981	22.01	20.5	22.01	12.6	0.00	18.7
1982	22.32	1.4	19.28	-12.4	+3.04	18.1
1983	22.23	-0.4	21.39	10.9	+0.84	18.2
1984	26.14	17.6	27.41	28.1	-1.27	21.3
1985	27.35	4.6	42.25	54.1	-14.90	29.4
1986	30.94	13.1	42.91	1.6	-11.97	32.7
1987	39.44	27.5	43.21	0.7	-3.77	33.1

Source: Dernberger,
"China's Economic Reforms",
Asia-Pacific Report
(East West Center, 1989).

TABLE 7

Shares of Exports/Imports of Selected Countries in World Trade

(Per cent; top row = exports
bottom row = imports)

	1975	1980	1985	1987
China	0.9 0.9	0.9 1.0	1.5 2.2	1.6 1.8
Asian NIEs	2.7 3.3	4.0 4.5	6.2 5.6	7.4 6.4
Rep. of Korea	0.6 0.9	0.9 1.1	1.7 1.6	2.0 1.7
Hong Kong	0.7 0.8	1.0 1.1	1.6 1.6	2.0 2.0
ASEAN	1.9 1.8	2.5 2.0	2.5 2.0	2.2 1.9
Thailand	0.3 0.4	0.3 0.5	0.4 0.5	0.5 0.5
Malaysia	0.5 0.4	0.7 0.5	0.8 0.6	0.7 0.5
United States	13.3 12.6	11.8 13.1	11.9 18.5	10.6 17.3
Japan	6.8 6.9	6.8 7.2	9.7 6.9	9.6 6.1

Note: NIEs: Thailand, Republic of Korea, Taiwan, Hong Kong and Singapore.

ASEAN: Thailand, Philippines, Malaysia and Indonesia.

Sources: IMF, "International Financial Statistics"; national statistics of individual countries.

China seems to have grown in this brief period from a developing country with one of the lowest foreign trade dependency ratios in the world to a large foreign trader with an exceptionally high foreign trade dependency ratio for a large continental country at any level of economic development.⁴⁹ A significant feature of the growth of China's foreign trade is the closer link it is now having with the Pacific-basin countries. Unlike in the early fifties when most of the trade was with the Soviet bloc, in 1987, the Pacific-basin countries accounted for nearly 65 per cent of China's exports (Table 8). China's share in the exports of these economies has also increased. The growing link with Hong Kong is particularly noticeable. China now accounts for almost one-fourth of Hong Kong's exports while about one-third of China's exports now go to Hong Kong.

TABLE 8

	(Per cent)				
	Japan	Asian NIEs	Hong Kong	ASEAN	United States
<u>Share in China's exports:</u>					
1970	10.0	23.4	18.4	4.2	0.0
1980	22.3	26.4	24.1	4.3	5.4
1987	16.2	38.2	34.8	2.5	7.7
<u>China's share in total exports:</u>					
1970	2.9	0.5	0.4	0.5	0.0
1980	3.9	2.0	6.3	0.8	1.7
1987	3.6	6.8	23.3	2.1	1.4

Source: IMF, "Direction of Trade Statistics", Bank of Japan Special Paper 176.

With the relaxation of controls over foreign trade, imports grew rapidly to meet the shortages which were enormous (and grew more acute with industrial production running at a high rate), outstripping exports and showing up in huge trade deficit. The gaps were met with massive capital inflows (Table 9) in the form of both borrowings and direct investments, bulk of the latter flowing from Hong Kong, US and Japan.

TABLE 9

China's External Borrowing and Direct Foreign Investment

(US \$ 100 million)

	1979-84 (Average)	1985-87 (Average)	1983	1984	1985	1986	1987
External borrowing	21.7	45.0	10.7	12.9	26.9	50.1	58.1
Direct foreign investment	5.1	19.5	6.4	12.6	16.6	18.7	23.1
Of which from							
Hong Kong	n.a.	13.8	n.a.	7.5	9.6	13.3	16.0
U S A	n.a.	3.2	n.a.	2.6	3.6	3.3	2.6
Japan	n.a.	2.7	n.a.	2.2	3.2	2.6	2.2
Total	28.6	67.9	19.8	27.1	46.5	72.6	84.5

Source: Bank of Japan, Special Paper No. 176.

e. Saving, investment and financing pattern?

At the macro level, the reform made a major impact on the pattern of saving and investment and financing of investments. Decentralisation has implied, as presumably was its underlying aim, shifting the responsibility for investment financing from the government budget to the enterprises. If anything, decentralisation was supposed to reduce the dependence of the enterprises in the matter of their investment on the State and induce them to rely more on their own resources (retained earnings) or the financial system. It was probably expected that with greater autonomy, investment decisions of enterprises and financing institutions would be guided more by "profit-focused calculus" and thereby secure more efficient resource mobilisation and allocation. As a supportive measure, radical changes were made in the financial system and in the role of the People's Bank of China (PBC) which had so long functioned as a mono-bank. Through several measures initiated in 1979, the PBC was relieved of its ordinary banking operations and these were now assigned to newly set up (or revived) specialised banking institutions like the Agricultural Bank of China and the Industrial and Commercial Bank of China. While the Bank of China continued to handle the bulk of foreign exchange transactions, two new institutions were set up to channel foreign funds, one was the China International Trade and Investment Company, (established in 1979 under the State Council to look after joint ventures with foreign enterprises and help to attract foreign funds into China) and the other, the China Investment Bank, meant to serve as a channel for World Bank loans to the industrial sector. Similar institutions were set up at the provincial levels. The PBC was thus expected to move over from exercising the role of allocating investible funds directly to enterprises to a system whereby it would act as the central monetary authority to oversee the creation

and flow of credit with instruments or levers of indirect control, as in all mixed economies. Along with changes in the banking system, non-banking institutions have also come up, providing leasing and other services.

The impact of the changes described above can be seen from Table 10. With decentralisation, there was a drop in the saving ratio initially from 35.5 per cent of GDP in 1978 to 31 per cent in 1982. The ratio picked up again and crossed the earlier peak in 1986, reaching 38.7 per cent in 1987. More striking is the drop in the share of government budgets and enterprises in gross domestic savings from 97 per cent in 1978 to 56 per cent in 1986. Correspondingly, household sector's contribution to domestic savings increased from 3 per cent to 44 per cent during the period. Between 1978 and 1982 the share of enterprises and local governments increased from 53 to 57 per cent (according to World Bank estimates, the increase was from 34 per cent to 57 per cent). These shifts apparently were brought about by retention of earnings by the enterprises on the one hand and decentralisation of the tax base depleting the Central government's revenue on the other but there has been a sharp drop in the share of enterprise savings thereafter, probably because of taxes and larger sharing of profits with employees (in the form of bonus, etc.).

One explanation for the dramatic rise in the household sector's share in domestic savings could be the accrual of larger incomes to households and better supply of consumer durables. Expansion of bank branches and marketing of several attractive saving instruments by the banks helped to channel an increasing share of the household savings into the financial system. Household saving accounts grew by nearly 30 per cent per annum between 1978 and 1985 as against 10.6 per cent over the previous 25 years. Rural deposit growth rate increased from 9.6 per cent to 34.5 per cent per annum.¹⁰

TABLE 10

Developments in Savings and Investment, 1978-87
(In per cent of GNP)

	1978	1982	1984	1985	1986	1987
<u>Savings and Investment</u>						
Gross domestic investment	36.2	29.1	32.2	38.7	38.8	38.6
Of which: State budget	(14.7) ¹	(6.2)	(6.8)	(5.3)	(5.0)	(...)
Gross domestic savings	35.5	31.0	32.4	34.5	36.1	38.7
State budget (Central government)	15.4 (43.4)	5.6 (18.1)	6.7 (20.7)	7.2 (20.9)	6.1 (16.9)	...
Households	1.2 (3.4)	7.8 (25.2)	14.8 (45.7)	13.8 (40.0)	16.1 (44.6)	...
Of which: Financial savings	(...)	(4.2)	(8.7)	(7.4)	(9.2)	(...)
Enterprises and other (Local governments)	18.9 (53.2)	17.6 (56.8)	10.9 (3.6)	13.4 (38.8)	13.9 (38.5)	...

Note: 1. Based on State budget. Other figures based on national accounts.
2. Includes changes in households demand deposits, savings deposits, currency holdings and treasury bonds.

Source: 'Economic Reform and Macroeconomic Management', paper presented by IMF staff at the seminar held at Shen Zhen, China, Nov. 7-13, 1988.

There was a decline in gross domestic investment in the initial years of the reform from 36.2 per cent in 1978 to 29.1 per cent in 1982 but the investment rate recovered and was running at over 38 per cent in 1987. The proportion of investments flowing from the government budgets fell from 43 per cent in 1978 to 18.1 per cent in 1982 and has remained at about that level since then (Table 10). The rate of growth of output in the State-owned enterprises also turned out to be lower than that of collectives and other units resulting in a decline in the share of the form in the total value of output and reflecting the shifts in the investment pattern, although the dominant position of the State enterprises in the total industrial output of the economy remains (Table 11).

TABLE 11

Gross Industrial Output Value, By Form of Ownership, 1980-85

(Billions of Yuan at constant 1980 prices)

Year	Total ^a	State-owned	Collectively owned	Individually owned	Other ^b	State share in total (%) Col.3 - Col.2
1	2	3	4	5	6	7
1980	497.2	391.3	103.0	0.1	2.9	78.7
1981	517.8	405.4	108.9	0.2	3.2	78.2
1982	557.7	434.0	119.3	0.3	4.1	77.8
1983	616.4	474.5	135.4	0.8	5.5	77.0
1984	703.0	517.1	175.8	1.5	8.6	73.5
1985	829.5	584.0	230.1	3.3	12.0	70.4

a Does not include the output of brigade Source: World Bank Country Study on China (1988).

b Includes joint enterprises combining more than one ownership form, foreign joint ventures, and foreign enterprises. Original source: State Statistical Bureau, Statistical Yearbook of China, 1985 and 1986.

Another notable change in the investment pattern is the shift in the proportion of investment in capital construction and that in technical transformation and modernisation (Table 12). Whereas, in 1975, capital construction accounted for 75 per cent of the total investment in fixed assets by State-owned enterprises, in 1985 the proportion had come down to 64 per cent and correspondingly, the proportion of investment in technical transformation and modernisation increased from less than 25 per cent earlier to over 36 per cent. The impact of these shifts following the decentralisation process on the allocation of investment between productive and non-productive heads and among different sectors is depicted in Tables 13 and 14.

TABLE 12

Investment in Fixed Assets by State-owned Enterprises, 1965-85

(Billions of Yuan)

Year	Total investment	Capital construction investment	Per cent financed by State budget	Technical trans. and mod. investment	Per cent of Col.5 in total
1	2	3	4	5	6
1965	21.7	18.0	90.8	3.7	17.2
1970	36.8	31.3	87.3	5.6	15.1
1975	54.5	40.9	82.0	13.6	24.9
1979	69.9	52.3	80.0	17.6	25.1
1980	74.6	55.9	62.5	18.7	25.1
1981	66.8	44.3	56.8	22.5	33.6
1982	84.5	55.6	49.8	29.0	34.3
1983	95.2	59.4	58.2	35.8	37.6
1984	118.5	74.3	54.4	44.2	37.3
1985	168.1	107.4	42.1	60.6	36.1

Source: China - Finance and Investment, World Bank Country Study (1988).

TABLE 13

Distribution of Investment Between Productive and Non-productive Sectors 1958-85
(Billions of Yuan)

Years	Total	Productive	Non-productive	Of which: Housing
1958-62	120.6	103.0	17.6	5.0
1963-65	42.2	33.5	8.7	2.9
1966-70	97.6	81.8	15.8	3.9
1971-75	176.4	145.5	30.9	10.1
1976-78	126.0	100.6	25.4	8.8
1979	52.3	36.5	15.8	7.7
1980	55.9	35.9	20.0	11.2
1981	44.3	25.2	19.0	11.1
1982	55.6	30.3	25.3	14.1
1983	59.4	34.6	24.8	12.5
1984	74.3	44.3	29.9	13.4
1985	107.4	61.1	46.3	21.5

Source: *China - Finance and Investment*,
World Bank Country Study (1988).

Original source: State Statistical Bureau, *Statistical Yearbook of China*, 1985 and 1986.

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TABLE 14

Sectoral Distribution of Investment 1958-85
(Per cent)

Years	Total	Industry	Agriculture ^a	Transport ^b	Social ^c	Other
1958-62	100.0	60.4	11.3	13.5	3.8	11.0
1963-65	100.0	49.8	17.7	12.7	5.7	14.1
1966-70	100.0	55.5	10.7	15.4	2.8	15.6
1971-75	100.0	55.4	9.8	18.0	3.1	13.7
1976-78	100.0	56.3	11.0	14.2	4.0	14.5
1979	100.0	49.1	11.1	12.2	6.4	21.2
1980	100.0	49.3	9.3	11.2	7.9	22.3
1981	100.0	48.8	6.6	9.1	9.8	25.7
1982	100.0	46.9	6.1	10.3	9.2	27.5
1983	100.0	47.5	6.0	13.1	10.0	23.4
1984	100.0	46.0	5.0	14.6	10.6	23.8
1985	100.0	41.6	3.4	15.9	11.2	27.9

- a Includes forestry, water conservation, and meteorology.
 b Includes postal services and telecommunications.
 c Includes scientific research, culture, education, public health and social welfare.

Source: *China - Finance and Investment, World Bank Country Study (1988)*.

Original source: State Statistical Bureau Statistical Yearbook of China, 1985 and 1986.

IV. Strengths and Weaknesses

Scepticism about Chinese statistics notwithstanding, it is universally acknowledged that the post-1978 reforms have had major successes especially in reversing the past trends in the structure of the country's economy, and stagnation especially in living standards and bringing about appreciable improvements in the consumption levels of the people. While, as noted, investment has continued at a high level (after an initial drop), there has been a better utilisation of capacities than before. In fact, efficiency in resource use seems to have improved significantly, narrowing the large gaps which were there between potential and actual output.

According to Dwight Perkins, a renowned scholar on China, the most convincing evidence of a positive impact of the reform on the performance of China's economy is the growth rate of what is known among western economists as 'Net Material Product' (NMP). Calculations made by Perkins suggest that the growth rate of NMP in the post-Mao era (1976-85) had shot up to 9 per cent per annum, contrasting with 3.9 per cent during the preceding two decades and 6.2 per cent in the first five year plan (1952-57) (presented in Table 15), and although there was both an increase in the growth rate of capital stock and in the rate of growth of factor productivity, it was productivity growth which displayed more significant change.¹¹ During the 19 years 1958-87, total factor productivity did not grow at all, while in the years following 1977, productivity growth contributed 40 per cent of the total growth. While estimates differ about the extent of the contribution of productivity growth in China's economic performance after the reform,¹² it would seem that a major source of the strength which the economy seems to have acquired through the reforms is improvement in efficiency, testifying to the efficacy of the

incentives introduced into the system through contract responsibility system, decentralisation and permitting the operation of the market albeit only on a somewhat limited scale.

TABLE 15
Sources of Growth
(Percentage Increase Per Year)

Period	Growth rate of net material product (1980 prices) (G_Y)	Contribution of increase in capital stock ($W_K G_K$)	Contribution of increase in labour force ($W_L G_L$)	Contribution of increased productivity (a)
1953-57	6.61	0.84	1.67	4.10
1957-65	2.09	1.87	1.63	-1.41
1965-76	5.11	2.81	1.68	0.62
1976-85	8.78	3.30	1.69	3.79

Methodology: These figures are derived from an aggregate production converted into the standard growth accounting form:

Source: D. Perkins, 'Reforming China's Economic System', *Journal of Economic Literature*, June 1988.

$$G_Y = a + (W_K G_K) + (W_L G_L)$$

- where G = the growth of the variable in question
- Y = net material product or national income, as the Chinese define that term
- K = the capital stock
- L = the total labour force
- W_K = elasticity of output with respect to capital
- W_L = elasticity of output with respect to labour
- a = productivity growth or the residual derived by subtracting the contribution of labour and capital inputs.

However, rapid growth has encountered problems and these surfaced in an acute form in 1988 with huge trade deficit and rapid inflation. In the absence of effective instruments of macro-management of the economy decentralisation has led to unbridled growth of money supply. The social impact of the reforms also appears to have been negative inasmuch as in the rural areas income disparities have started widening while provision of public services like health and education has suffered. And so have several important aspects of the economy like investment in infrastructure, power and transport, leading to bottlenecks.

While efficiency improvement has helped better utilisation of capacities, it should not be overlooked that China's growth in the 1980s has been propelled also by high levels of investment. This, coupled with export growth, contributed to excessive growth of demand. The supply-demand gap was exacerbated by the tendency to build up stocks both in business and households. Absence of effective macro control further aggravated the situation resulting in the worst inflation experienced by China's economy since 1949. Agricultural production too has stagnated after 1984, compounding the problems which surfaced in 1988.

Both capital and consumer expenditure recorded sharp growth in 1988 (commodity retail sales grew by 27.8 per cent and fixed capital investment by 18.5 per cent). Pressure on demand was built up also by the relatively large proportion of investment in inventory (8.3 per cent of GNP, as of 1985-87, as compared to 0.5 per cent of USA and Japan and 4.1 per cent of India). Considerations which seem to induce such high level of inventory investment in China are believed to be: underdeveloped transport system, uncertainty of supplies, low interest rates and poor spread of modern inventory control techniques.

Constraints on the supply side, on the other hand, stood in the way of domestic production going up to meet the demand. In 1987 and 1988, items like colour TVs and refrigerators recorded fast growth (54 per cent and 86 per cent respectively), whereas power generation grew by only 9 per cent, crude oil by 2 per cent, coal by 5 per cent, steel 7 per cent and cement 14 per cent (Table 16)]. Ironically, there has been some stagnation in capacity utilisation in major machinery equipment in the 1980s. This is attributed by some to outmoded equipment or inefficient resource allocation. Rigidity in domestic production in key sectors seems to have led to a marked rise in imports of intermediate and capital goods. To meet these requirements China has to improve the income elasticity of exports and reduce that of imports. This underlines the need for improving international competitiveness of the country's products especially industrial goods.

In this context, it has been observed that the rapid rise in wages that has taken place, outstripping the increase in labour productivity, is a negative feature of China's recent economic development (vide Table 17). During 1979-87, total wages have increased by 10 per cent as compared to a growth of 7.5 per cent in total productivity. The gap is particularly wide in State-owned enterprises (10 per cent as against 4.2 per cent). Adjustment of exchange rates could perhaps alleviate the imbalance between imports and exports to some extent. But the relatively low price elasticities of imports and exports - as perhaps is the case with India - cautions against expecting much help from currency devaluation. Without a curb in wage rise, China's products are unlikely to be competitive in the world market and the trade gap will continue.

TABLE 16
Output of Industrial Products

(Year-to-year per cent volume change)

	1985	1986	1987	1988
Industrial Production	21.4	11.7	17.7	20.7
Machinery and electric products sector:				
TVs	66.1	-12.5	32.5	28.7
Colour TVs	(213.4)	(5.7)	(57.6)	(54.1)
Refrigerators	164.5	55.4	78.4	85.9
Tape recorders	79.4	26.1	12.6	24.2
Motor vehicles	38.2	-15.4	27.6	36.9
Materials and energy sector:				
Electricity	8.7	9.4	10.7	9.3
Crude oil	9.0	4.6	2.6	2.0
Coal	10.2	2.3	3.3	5.4
Steel	9.5	9.9	8.1	7.1
Cement	18.6	13.8	12.2	13.5
Chemical fertilisers	9.9	6.8	19.5	3.8

Source: State Statistical Bureau, 1988
Statistical Yearbook of China,
Monthly Bulletin of Statistics,
Bank of Japan.

TABLE 17

Growth of Wages and Labour Productivity

(Average year-to-year per cent change)

	1979-87	1979-84	1985-87
TOTAL:			
Wages	10.0	7.7	14.6
Productivity	7.5	6.0	10.4
Agricultural Sector:			
Wages	12.4	12.9	11.3
Productivity	5.2	6.2	2.6
Industrial Sector:			
Wages	9.9	7.8	14.4
Productivity	6.8	4.9	10.6
State-owned enterprises:			
Wages	10.0	7.8	14.4
Productivity	4.2	4.3	3.9
Non-State-owned enterprises:			
Wages	10.2	8.3	14.1
Productivity	10.7	8.8	14.7

Note: 1. Wage growth on a nominal basis and labour productivity on a real basis.

Source: Bank of Japan
Special Paper
No. 176.

TABLE 18

China : Selected Macroeconomic Indicators, 1983-88

	1983	1984	1985	1986	1987	1988
<u>Inflation</u>						
General retail prices (average annual change in per cent)	1.5	2.8	8.8	6.0	7.3	18.5 ¹
Market prices (average annual change in per cent)	4.1	0.3	16.9	7.7	17.2	24.5
<u>Money (end-year per cent change)</u>						
Broad money	19.3	42.4	17.1	29.3	24.2	28.5 ²
Narrow money	17.2	42.9	11.5	27.6	19.6	29.4 ²
Currency in circulation	20.7	49.4	24.7	23.3	19.4	35.9 ²
<u>State budget (in per cent of GNP)</u>						
Revenue	28.3	27.1	27.5	26.0	23.4	21.9 ³
Expenditure	30.0	28.7	28.0	27.9	25.7	24.0 ³
Deficit	-1.7	-1.6	-0.5	-1.9	-2.3	-2.1 ³
<u>Balance of payments</u>						
Exports (\$ billion)	20.7	23.9	25.1	25.8	34.7	...
Imports (\$ billion)	-18.7	-23.9	-38.2	-34.9	-36.4	...
Current account (\$ billion)	4.5	2.5	-11.4	-7.0	-0.3	...
Current account (per cent of GNP)	1.6	0.9	-4.0	-2.6	0.1	...

1 Between July and December 1988,
retail prices went up by 24
per cent.

2 End-June, 1988.

3 Budget.

Source: 'Economic Reform and
Macroeconomic Management'
paper presented by IMF
staff at the seminar held
at Shen Zhen, China, Nov.
7-13, 1988.

The imbalance between demand and supply was exacerbated by rapid increase in money supply since the beginning of 1988, as the growth of currency in circulation exceeded 40 per cent. This came on top of an increase of more than 20 per cent per year since 1983 (Table 18). Sharp rise in bank lendings - fuelled partly by falling (and since late 1987, negative) real rate of interest - was an important source of the increase in money supply. China did not have the instruments and institutions of monetary control needed to tackle the price situation which was already under pressure because of the removal of controls on the prices of several commodities. Persistent budgetary deficits were yet another factor feeding away supply growth and inflation. Growth of financial savings which took place during the period was far from adequate to neutralise the impact of money supply growth in the economy.

Rapid rise in prices led to panic buying and stock hoarding so much so that in September 1988, a campaign was mounted to allay panic and dissuade households from needless stockpiling. The campaign however does not seem to have made much difference. It was not until severe measures were taken towards curbing demand that the situation came under some control. Efforts towards cooling down the economy seemed to have yielded some results this year as industrial production growth came down to 8.2 per cent in January 1989 from nearly 19 per cent in the last quarter of 1988. With the further austerity measures and resumption of central control over investment and use of foreign exchange now announced, the economy may be able to regain stability and weather the turbulence which it was going through in 1988. The authorities possibly found no option but to go in for these tough measures in the absence of effective instruments of monetary and fiscal control.

Another negative impact of the reform seems to be on distribution of income and provision of social services especially in the rural areas. The reforms are reported to have generated inequalities in the countryside which

Communist China had been striving to remove. Permission to acquire properties and retain profits has resulted in the reappearance of old merchant princes and commercialisation of rural cadres. Gaps between the income of peasants who do not have any side income and those in new industrial units appear to be widening and there are reports of tension in the countryside with poor peasants attacking their rich neighbours. According to Perkins there is no evidence to show conclusively that inequalities in China have increased as a result of market-oriented reforms (just as there is no good basis for the view that inequalities had decreased during periods like the Cultural Revolution). Rather, there are some clear indications of a decline in the rural-urban income gap which on the whole should have a wholesome effect on the distribution of income. Available figures suggest that urban worker to peasant income ratio narrowed from 2.35 in 1978 to 1.7 in 1984 but again it went up to 2.1 in 1986. However, these figures take no account of the liberal subsidies which are enjoyed by urban workers and not open to farmers (e.g., subsidies on urban housing, transportation, medical care, food, etc.). Subsidies given to employees in State enterprises are believed to have increased and surpassed their cash wages in 1982. Per capita subsidies for urban families working in State enterprises were estimated at 300 Yuan in 1982 while for peasants these came to only 10. Overall, however, Perkins is of the view that the economic benefits of the post-1978 reforms were widely shared. Another recent study on China also points out that increased inequality does not mean that there has been no improvement in the real income of the rural poor. In 1978, the proportion of peasants having income of less than 80 Yuan a year was about 35 per cent. In 1984, the proportion of those having income of less than Y 150 was 16 per cent. Even allowing for a doubling of prices, it is pointed out, the real income of many poor peasants had clearly increased. "True, millions are still very poor, but less poor than a few years ago."¹³ However, growing inequality in rural incomes cannot but cause misgivings about

the reforms especially if it stems from greater regional inequality (which might be accentuated by restrictions on migration, barriers to interregional movement of farm products and so on) rather than rural reforms themselves.

While opinions differ on the impact of the reforms on inequality, China scholars seem to agree that the reforms have led to virtual abrogation of many of the responsibilities by the Chinese authorities which really belong to the government. With the abolition of communes there has been a shift from one extreme to another - from too much government to too little of it.¹⁴ In the absence of any agency in rural areas having the authority to collect taxes, there are no longer any resources for financing health and education services or taking care of maintenance of irrigation and flood control or the expansion of processing and marketing facilities. Even infant mortality is reported to have increased (though this lacks corroboration). Some attempts have been made to alleviate these problems, e.g., by exhortation to build rural highways through semi-voluntary labour but the investment priorities reveal strong urban bias.

Then there are widespread complaints about corruption. Relaxation of central control and partial freeing up of prices left wide scope for making money through illegal means on the part of officials as also businessmen. One of the most vulnerable features of the reforms has been the growth of permissiveness all round which Communist China was not used to. Although this allowed the people to breathe the air of freedom to some extent, the cost appears to have been high.

V. The Key Questions

If one were to draw up a balance sheet of the results of the reforms, the pluses would perhaps outweigh the minuses. As Demberger sums up, the economy's growth has accelerated; more importantly, the growth is more stable than in the past and agricultural and services sectors have grown at a much faster pace. Per capita income and consumption are significantly higher than before. Trade and services are reviving and China has rejoined the world economy on a significant scale.

But, again, as Demberger himself points out, the major changes in economic performance in China have been only in *direction* and not so much in the character of the economy. Two basic questions for which a clear answer is difficult to find remain: (i) Have the reforms created a new economic system in China, and (ii) have they helped to solve China's basic long-term economic problem?

One view is that the change in direction which has taken place in functioning of China's economy will eventually result in establishing a full-fledged capitalist market system or a market-socialist system while another view is that the changes are minor and temporary. The latter view might draw support from the fact that the economy continues to be dominated by the State and State-owned enterprises and most of the basic institutions remain unchanged. The most recent events and the move to resume central planning would seem to confirm the doubts about the depth and permanence of the changes brought about by the reforms.

Even before the recent events, Perkins and several others had drawn attention to the absence of the four essential features required to make a market system work in the Chinese economy even with all the reform. These are: (i) creating markets for inputs and outputs; (ii) making enterprise

managers behave in accordance with the rules of the market; (iii) introduction of competition and abolition of monopoly power and (iv) setting prices in accordance with relative scarcities. In all these China has gone only some distance and that too haphazardly. On the other hand, many observers point out that the changes that have taken place are collectively too significant to be regarded as just temporary deviations from the traditional system of Soviet type central planning and central allocation of factors and products. Moreover, China has never been a fully controlled economy in all sectors.¹⁵ A large sector - especially in the rural areas - remained outside the purview of planners all along. The reforms, besides, were also not initiated in a planned way but originated out of local initiatives in some provinces to break out of stagnation. It is the results of the initiatives in agriculture to move towards family contract responsibility system - for whose success strong theoretical support has now been advanced by Justin Lin¹⁶ - which led the policy-makers to lean towards the market system.

The problems besetting the reforms are attributed by most observers not so much to the inherent shortcomings of the reforms as the fact that the reforms have been partial and uncoordinated. The partial nature of price reform in particular is cited as the main stumbling block in the progress towards a market or a mixed market system. At the seminar on China's Economic Reform held at Shen Zhen last year, a strong plea was made by some of the keen observers to advance the reform in a more systematic and fundamental way by carrying the reform in prices and ownership to their logical end, instead of reverting to a centralised system of resource allocation. Enterprise managers participating in the seminar bitterly complained about interference by government and party officials. Majority seemed to favour much further progress towards the market system, doing away with the dual track price system. Some even went to the extent of suggesting that the State-owned enterprises sell away their assets to local authorities, individuals and even foreigners.¹⁷ In other words, the belief that was

gaining ground was not that the reforms had failed but that they had not gone far enough (at least that is what was being aired openly by many influential economists before the recent events).

Given the strong support which the suggestions for pushing with the reforms had been gathering in 1988 and earlier this year, total abrogation of the reforms seems unlikely, announcements designed to reassert central authority notwithstanding. The question however remains: will a full-blooded market system help China to get over its long-term economic problems? After all, the future of the Chinese economy depends on how the basic long-term problems are addressed and these, as Dernberger points out, remain to be solved. The problems are first, the policy of developing the coastal region - the 'dragons' - may not lead to percolation of the benefits to the interior. How to carry the entire country along will remain a big task. Further, there are several other fundamental economic problems - agricultural development, creation of employment opportunities, urbanisation and production of competitive products. These are the basic problems in the process of modernization and growth common to all large sized developing countries like China and India. Dernberger feels the reforms so far may not have helped in meeting them, rather might have made them more difficult. In agriculture, in particular, it is now being realised that the creation of small, scattered holdings may stand in the way of realizing the economies of scale. Expressing doubts about the wisdom of allowing the peasants to go back to household farming, Dernberger says:

"In the long run, it is likely that China's leaders will be forced to recognise that they may need a somewhat different institutional organisation that involves larger units of production and that has responsibility for investment decisions and the maintenance of the rural infrastructure."

Perkins too has expressed reservations as to the basic factors which provided the impulses for growth in agriculture. Similarly, China needs to develop a real labour market to solve the long-term problem of providing employment opportunities. Instead of concentrating on the development of small-scale urban centres to serve local areas, it would be more fruitful, Demberger suggests, to develop a "rational urban hierarchy centred in the major urban centres of consumption and production that are the proven locations of both population and income throughout Asia." As for improving competitiveness, it is believed that no tangible results can be achieved unless firms are made responsible for their losses and the protection of the State is completely withdrawn. So far, the reforms have done little to move in this direction and thus the gains in the form of product quality improvement or innovation and efficiency or cost reduction have not been very substantial. On the other hand, delegation and decentralisation have eroded the capacity of the State to undertake investments in infrastructure and energy which alone can remove the bottlenecks underlying the overheating and the accompanying problems. Relaxation of physical controls without the institution of a mechanism of indirect control has meant virtual chaos in the matter of macro-management. All this had cast a shadow on the reforms programme itself.

VI. Concluding Comments

The question which is uppermost in the minds of China observers is, does the recent reversal mean the end of the reforms? This is a question to which time alone can provide the answer. Pessimists see China as of now as at "the end of the capitalist road" and predict that unless the country is able to evolve a coherent, effective government with the support of the people to steer a way to national survival through the rapids into which the reforms have led it, "there will be an ineluctable regression into the disorder,

fragmentation and renewed mass poverty from which its revolution once rescued it."¹⁸ Even before the recent events, Bettelheim had cautioned that to resolve its immense problems, China has to support the development of a broad democracy. No doubt, the signs so far leave no room for any optimism that the political environment required for the reform to continue will be forthcoming.

Nevertheless, it is doubtful whether the reforms will really be jettisoned. China is too vast a country to be ruled indefinitely through central planning. Also too many people now have benefited from the reforms to permit restoration of the earlier rigidities and controls. The present policy-makers, whatever they may say to counter their critics, are amply aware of this. The momentum gathered by the reform has gone beyond the point of no return. It is salutary to remember that the initiative for reform came from the people themselves in the rural areas. The imprimature of planners and policy-makers came as *ex post facto*, overwhelmed by the results achieved. A further, very strong impetus is provided by the success of the market economies of the NIEs in China's neighbourhood, with whom the Chinese people obviously are keen to march along, and not be left behind. Most important, the present leaders of China are too pragmatic to bring back central planning in the same form as before. However, for solving its long-term problems, China will sooner or later have to recognise that there is no alternative to massive investments in several fields like energy, communications and transport which only the State can undertake and that salvation probably lies in a mixed system in which the State assumes a role more than that of merely passive or indicative planning.

Viewed in this light, it would seem that China cannot afford to give up physical planning altogether but has to develop instruments and institutions of indirect macro-management of the economy. In this respect India's policy to adopt the strategy of planning within the framework of a

mixed economy seems to have been wise and, in the present situation, there is a wide field (such as creation of a legal framework and banking and monetary institutions) in which India's experience could be of interest to China.

Of course, India seems to be plodding for many years despite these advantages. The explanation for the slow progress probably lies in its socio-political structure, especially the sharp inequalities and vested interests which thwart the implementation of the plans on the one hand and of the healthy functioning of the market on the other. In many ways, China is in a better position to experiment with the market in a controlled fashion. Whether the political system will permit this is the crucial question for which the answer has to be sought beyond the realm of economics. Developments so far do not warrant pessimism about the country's future. It is noteworthy that Japan, China's closest neighbour, has chosen to be circumspect in its comments on the harsh handling of the democracy movement by China's leaders and has not done anything to halt inflow of funds to China. Western countries too are watching. Flow of private investment may however slow down. In any case, China may turn to India in this situation more than to any other country, offering an opportunity for the two countries to come together once again than ever before in the recent past. At the same time India too can gain much from a closer association with its great neighbour.

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8. Vide f.n. 6.
9. This part of the paper draws upon the World Bank Country Study, *China : Finance and Investment* (1988) and a paper by D. Scott of IMF presented at the international seminar on China's Economic Reform held in November, 1988 at Shen Zhen.
10. World Bank Country Study, *op. cit.*
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12. According to estimates given by Wu Jinglian, a leading economist of China, annual total factor productivity growth was 0.6 per cent, which was no doubt higher than the 0.1 per cent growth observed during 1956 to 1979 but much lower than the 3.8 per cent registered in 1953-57. According to Jinglian, in the period 1981-85, the contribution of productivity improvement in the sources of industrial growth was 8.2 per cent, lower than that of major industrial countries ("Choosing a Strategy for China's Economic Reform" by Wu Jinglian, paper prepared for the annual meetings of America Economic Association, December 1987 and also presented at Seminar on Economic Reform in China held in Shen Zhen in November, 1988).

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