

*By Chi Fulin*

# PRESSING TASKS OF CHINA'S ECONOMIC TRANSITION

FOREIGN LANGUAGES PRESS BEIJING



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## Preface

Having entered a key period in the overall transformation of her economic system on the basis of the successful and progressive reform policy, China plans to accomplish the strategic task of transforming the traditional planned economy system into a market economy one in the next 15 years. However, there still exist a series of problems calling for prompt solutions if China is to quicken the pace of her economic reform and smoothly push forward the transition towards a market economy system taking into account her concrete conditions.

Although the overall goal of China's economic reform has been quite explicitly decided upon, all important reform programs call for in-depth studies and explorations before they are implemented. This is because overall economic transformation involves many extremely complicated and deep-rooted problems, and almost all important reform programs have varying degrees of complexity and involve deep-seated contradictions.

This book presents some tentative explorations into some of the major theoretical and practical issues arising in China's transition from the the traditional planned economy system toward a market economy one.

The theory and practice of China's economic system transformation would require a huge volume for a relatively thorough discussion and exploration. Besides, many issues have barely been touched upon until now. So I am willing to continue to exert my own efforts to contribute to the debate. For this purpose, comments and suggestions on the present book will be sincerely appreciated.

My heartfelt gratitude goes to the German Technical Cooperation Corporation, which sponsored the publication of this book, to my colleagues and friends at the China Foreign Lan-

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Chi Fulin  
June 4, 1996

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# **Restructuring China's Macro Economy: History and Development**

It has been 15 years since China began to restructure her economic system. The magnificent achievements scored in this period have attracted worldwide attention. The overall economic structure has undergone tremendous changes and the GNP has been increasing at an average of nine percent annually. The traditional economic system has basically been revamped and the elements of the new system have been constantly developing. In 1992 China set the goal of establishing a socialist market economy, which signified that the overall economic restructuring had entered an entirely new stage. In the process of restructuring, major breakthroughs have been made in the transformation of the macro economy. At present, in moving toward a market economy, the series of reform measures in the macro economy sphere will greatly accelerate the pace of transition.

## **I. The Historical Process of Restructuring China's Macro Economy**

Before 1978 the economic system in China was a highly centralized planned one, a system that incorporated the macro mechanism with the micro mechanism into one. The role of the government was not only to regulate the aggregate GNP, but also to be directly involved in the management of production and operation. The major production sectors were brought into line with state planning, and the fiscal management was to have all incomes from state-owned enterprises turned over to the central treasury department; in return, all necessary expenditures were disbursed by the department. The management of materials was

based on centralized allocation, transfer and rationing, and likewise fiscal management was based on centralized allocation in accordance with planning. Administration was carried out hierarchically by means of promulgating decrees and orders. This special characteristic of the administrative structure determined that a special approach had to be adopted in restructuring the country's macro economy. By giving more autonomy to the lower levels, with the expansion of enterprise autonomy and the development of the market, the restructuring of the macro economy in China has progressively unfolded. This restructuring since 1978 has basically undergone three stages, involving constant in-depth reform of the macro economy.

### **The first stage: December 1978 to October 1984**

In late 1978, at the 3rd Plenary Session of the 11th Central Committee of the Communist Party of China, a decision was made to shift the priority of the Party's central task to economic construction, and the historic mission of restructuring the economic system was put before the nation. During this period, the disadvantages of the incumbent economic system were pointed out as being excessive centralization of power in administration, the inappropriateness of merging governmental administration with enterprise management and the misguided economic egalitarianism in allocation. Hence the reform was oriented toward "transferring power to the lower levels and maximizing subordinates' interests" and toward following and utilizing the law of value and giving full play to the function of economic levers.

The restructuring of the economy in China was initiated in the rural areas. This brought about miraculous changes in a short time and accelerated the transformation of the traditional small-scale peasant economy into a commodity economy. The rural reform drive has enabled China's 800 million peasants to shake off poverty, to have adequate food and clothing and to approach a "comfortably well-off living standard."

Rural reform was carried out mainly in three areas. First was the implementation of the "household contract responsibility system." This was a departure from the highly centralized system

practiced by the people's communes. By allocating collectively-owned land to each peasant household on a contract basis operations are carried out in a decentralized manner, while the collective still retains the ownership of the land. This reform has not only transformed the former operational system in the rural areas, it has also, to a great extent, altered the former property relations due to the fact that it has brought about local accumulation of capital and ensuing benefits. Statistics show that, by the end of 1991 the average fixed assets of each peasant household equaled 1,497.09 yuan. Thus, the peasant household has not only become a production unit and a consumer unit, but also an investment and accumulation unit.

Second was the transformation of the purchasing and sales system as well as the reform of the pricing system for agricultural by-products. Rationed purchase was implemented on a contract basis, and prices for most agricultural and side-line products were regulated by the market.

Third was the adjustment and transformation of the rural economic structure and the emergence of township and village enterprises, which have become the most important factors in the restructuring of the rural economy. The value of production of township and village enterprises in China exceeded 1,000 billion yuan in 1991, comprising 59.2% of the total production value in the rural area. The township and village enterprises have become the most dynamic force in the economic development of the rural economy. They have also increased the incomes of the rural population.

Areas outside the rural economy have likewise initiated reform experiments in several aspects. The experiments focus on the following: expanding the autonomy of enterprises in production and operation; actively developing diversified economic modes; transforming the circulation mechanism for commodities between urban and rural areas; giving full play to the economic function of metropolises; implementing the policies of opening up to external markets and establishing special economic zones; and opening the coastal cities for the expansion of international cooperation in economy and technology.

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In this stage, in conjunction with the practice of expanding the autonomy of enterprises, some adjustments were made in the macro economy in terms of reforming the urban economic system through delegating decision-making powers to the lower levels of administration and modifying managerial approaches. Major measures introduced during this period included gradually delineating income and expenditure, letting each level take responsibility for itself at the provincial, municipal and autonomous regional levels, and abolishing the practice of submitting all the profits of state-owned enterprises to the state and putting in its place a system of taxation. In the domain of finance, since 1979, specialized banks have either been restored or newly established, a central banking system has been set up and conditions have been created for the transition of direct control of loans toward indirect control. Centrally directed planning for agricultural production in rural areas has been minimized. In fact, by 1985 such planning for agricultural production has been basically terminated. At the same time steps have been taken to rely less and less on material goods which are subject to unified egalitarian allocation by the state.

### **The second stage: October 1984 to 1992**

In October 1984, at the 3rd Plenary Session of the 12th Central Committee of the CPC, a document titled *Decision of the Central Committee of the CPC Concerning the Restructuring of the Economy* was adopted. It explicitly postulated that the socialist economy was a planned commodity economy based upon market regulation, and thus established the orientation of the economic restructuring in China. Through a deep-going understanding of the flaws manifested in the traditional economic system, more and more people have begun to realize that, apart from the excessive concentration of power, other impediments inherent in the old structure included resistance to the market and the rigid allocation of resources. The idea of delegating more decision-making power to lower levels of administration while letting them retain a proportion of profits was scrutinized once again as a rationale for economic restructuring. In 1987 a basic

concept of the new economic structure was being ascertained. This included three major aspects: enterprises with autonomous power in business operation which bear responsibility for their own profits and losses; a sound market system; and a macro-control mechanism based mainly upon indirect guidance.

The strategy during this stage was to carry out the economic restructuring in the urban areas and the central link in the economic restructuring was to do a good job of revitalizing enterprises. The main contents of the restructuring of the macro economy during this stage included the following: planning, investment, finance, taxation, pricing, material sources, commerce and foreign trade. The number of items listed in mandatory plans and covered by the state's unified pricing was gradually reduced. Prices were gradually freed through the adoption of a "dual pricing" system. In addition, tax categories and tax rates were regulated. Adjustments were made on several occasions to the fiscal responsibility system. During the late 1980s and early 1990s experiments were carried out with regard to "divided taxation" and "divergence of taxes and profits." With the waning of direct state control, a series of reforms have also been carried out in finance, resulting in a rapid development of the finance and capital markets. With the strengthening of the implementation of economic policies and the functioning of economic levers to regulate the macro economy, the economic functions of pricing, rate of interest, rate of taxation and rate of exchange have all been constantly reinforced. Such a reform has brought about a great change in state administration, which used to call for administrative decrees and directives based upon hierarchical relationships. The role of finance as a means of indirect regulation has also been gradually strengthened in the steady progress toward indirect administration.

In this stage, with the constant eradication of the elements of the old economic administrative system and the gradual increase in market components, the regulatory role of the market has been greatly strengthened. However, the new economic relationship and the new pattern of profits formed during the process of economic restructuring are, on the one hand, a driving force that

impels economic development and serves as a major force that keeps at bay the traditional economic system at a time when two systems co-exist. On the other hand, in some areas the new vested interests and the old economic system are together an inhibitive force that runs counter to the tide of reform as well as to the newly established mechanism for macro economic administration. It is worth noting that the joint operation program of reform started in 1986, with regard to the reform of pricing, taxation and finance, was eventually proved to be a miscarriage due to immature conditions and various inhibitive forces. Therefore, during this stage, in which the macro economic administrative system was undergoing transformation, the sluggishness in the establishment of the new administrative system left much to be desired, though remarkable achievements have been accomplished in terms of making breakthroughs in the traditional system.

### **The third stage: since 1992**

In October 1992 the 14th National Congress of the CPC confirmed explicitly that the target of economic restructuring in China was to set up a socialist market economic model. Such a model would ensure the fundamental role of the market in distributing resources under macro economic regulation and control. To shift from a traditional planned economy to a planned commodity economy, and eventually to a market economy, represents a major development in the target model and guiding ideology for the economic restructuring of China. The economic reform will be unfolded in an all-round manner in accordance with the requirements for the establishment of the new socialist market economy system.

In the wake of the new round of overheating in the economy in the first half of 1993, which shook the economic order and introduced increasingly unstable factors in the macro economy, the central government exerted great efforts to regulate and control economic growth. The fluctuation in the national economy, the problems exposed in its operation as well as the practice of the state's macro-economic regulation and control have repeatedly demonstrated that China is short of means and levers for

indirect regulation and control on the one hand, and lacks a macro system that allows flexibility in their application on the other. The development of economy calls for the acceleration of economic restructuring, especially the speedy establishment of macro-economic regulation and control system that mainly depends on indirect yet effective means of regulation. The purpose is to strengthen the capacity of the state in its indirect regulation and control of market economy operations, and eventually help the national economy embark on a track of sound circulation, and healthy and speedy development. To this end, great efforts have been made in term of preparation. A series of major reform measures were introduced in 1994 with regard to finance, taxation, investment, foreign trade and foreign exchange, state-owned assets management and the institutional reform of enterprises. All these vital reform measures aim at the establishment of a basic framework for the state's macro-economic regulation and control in the socialist market economy system.

## **II. Historical Achievements in Restructuring the Macro Economy in China**

### **1. Restructuring the planned economy system**

(1) The background to restructuring the planned economy and its progress

Before the implementation of the policies of reform and opening up, China practised a highly centralized planned economy system which took shape during the first Five-Year Plan period (1953-1957). At that time, when China's economy was still underdeveloped, such a system played a great role in mobilizing limited resources for the initial establishment of a relatively intact industrial setup. But with the development of the economy serious drawbacks inherent in this system were gradually brought to light. From the 1950s to the 1970s several major measures of reform and adjustment were carried out to remedy these drawbacks. However, the measures were limited to adjusting the administrative jurisdiction between the central and the local and

between the departmental and the regional administrations, and the result was never-ending haggling over the issues of delegating or removing responsibilities. Since 1978 a better understanding has been gained in regard to the drawbacks inherent in the planned system, of which the major ones are: too centralized control in the state's planning; excessively rigid control exercised over enterprises; and a tendency to relying upon administrative means to distribute resources while ignoring the roles of the law of value and the market mechanism. A series of measures have been adopted to remedy these drawbacks.

In the first stage of reform (1979-1984), which was the preparatory stage as well as a stage for limited adjustment for the restructuring of the planned economy system, a target model was sought. At this stage, a new understanding of the role of the law of value and the supplementary role of market regulation was achieved. The outcome of this new understanding was the consideration and utilization of the law of value in formulating plans, which resulted in reducing the amount of state planning in the forms of directive targets for agricultural and industrial production, etc.

In the second stage (1984-1992), a stage which saw an all-round unfolding of the restructuring of the planned economy system, the key to the restructuring was to gradually reduce the scope of directive planning, to delegate administrative responsibilities for planning to lower levels, to stress the application of economic regulatory means and economic policies, to give full play to the market mechanism, to carry out different forms of the planned contract responsibility system, and to intensify the adjustment and orientation of the industrial setup through the formulation of the industrial policies. In reforming the management and operations of investment, responsibility was delegated to the lower levels of administration for the examination and approval of projects related to investment in fixed assets; at the same time, the scope for investment under the control of state planning was narrowed. In reforming finance, restructuring has been carried out to stop the utilization of construction capital without compensation; and, beginning in 1981, financial allocation has been replaced by bank loans in terms of investment for



replaced by bank loans in terms of investment for basic construction. In 1985 major developments were made in this transformation, followed by some other adjustments. The year 1988 saw the establishment of a central funding system for basic construction, which brought about the founding of specialized investment companies, etc. In the fiscal management of investment project, since 1984 a projects investment responsibility system has been introduced, in which the proprietor is responsible for the preparatory planning, fund raising and designing, followed by construction, production, operation and debt paying. He is also responsible for the value maintenance of state-owned assets.

In the third stage (since 1992) a new calculation system has been implemented, which has brought about an improvement in the economic evaluation index, further reduced the number of items included in directive production planning and developed a planning system based upon the market. Guided planning was introduced as a major means to accelerate the transformation of the role of the departments in charge of planning, and, to this end, advisory and information services were intensified. As regards investment, a risk-bearing responsibility system for bank loans and corporate investment will be gradually introduced; a system of project registration will replace the system of project application examination and approval; and a new planning system will be established in accordance with the requirements of the market economy.

(2) Major achievements and changes in the course of the restructuring of the planned economy

a. Reduction of plans with the nature of directives, narrowing down the scope of direct administration; utilization of plans with the nature of guidelines and fully displaying the role of market regulation.

—Abolishing all directive plans for agricultural production and the system of assigned purchasing of agricultural by-products. Before 1979, some 25 items of major agricultural products were covered by state directive planning. Also included in the directive plans for agricultural production were the plantation areas for 25 kinds of crops and the total yield of crops based