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**INTELLIGENCE
REPORT**

**BULLETIN DE
RENSEIGNEMENTS**

NO.:	DATE:
IR/BR 05	December 1984
63/84 1e 05	décembre 1984

CHINA: Economic Reform

CHINE: réforme économique

DEC 19 1984

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CHINA: Economic Reform

Summary

1. Encouraged by the success of farm incentive measures, the Chinese Communist Party plans similar reform in the urban economy. In order to improve resource allocation, prices are to be partially deregulated and central planning of output quotas is to be confined largely to heavy industrial companies, including those manufacturing military products. Consumer goods firms are to set their output and financial targets with only guidance by the state. Conflict between company management and the bureaucracy will arise as soon as firms attempt any fundamental restructuring of costs and prices. Opposition on matters of principle and the problem of finding workable programs to promote efficiency will make the five year period, 1986-1990, covering implementation of reforms, difficult.

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CHINE: réforme économique

Résumé

1. Encouragé par le succès des mesures d'incitation prises dans le secteur agricole, le Parti communiste chinois projette une réforme semblable pour l'économie urbaine. Afin d'améliorer la répartition des ressources, les prix seront partiellement déréglementés et la planification centrale des contingents de production sera limitée en grande partie aux entreprises du secteur lourd, dont celles qui fabriquent du matériel militaire. Les entreprises de biens de consommation fixeront leurs propres objectifs de production et de finance, l'État ne devant que les conseiller en la matière. Un conflit surgira entre les chefs d'entreprise et les bureaucrates dès que celles-ci tenteront quelque restructuration fondamentale des coûts et des prix. L'opposition exercée sur des questions de principe et la difficulté d'élaborer des programmes pour promouvoir l'efficacité feront de la période de cinq ans (1986 à 1990) couvrant la mise en oeuvre des réformes une période difficile.

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2. Encouraged by the success of farm incentive measures which have led to higher farm incomes, record harvests and reduced wheat import costs in 1984 by Cdn \$750 million for foreign wheat, the Chinese Communist Party plans similar reform in the urban economy. The remarkable success of the farm sector has strengthened the position of policymakers who have been pressing for more general economic liberalization and has enabled them to release a forceful declaration of intent to reform the structure of the urban economy.

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3. In the past month the Central Committee of the Party has indicated that the main priority of reform would be partial deregulation of prices with emphasis initially on those covering consumer goods and services; deregulation will only marginally affect producer goods (e.g. steel and engineering goods). Management, in consultation with other public officials, is to be permitted not yet clearly defined freedom to determine product prices and to undertake cost cutting measures. At present, state companies must accept fixed prices for output, tolerate high-cost overmanning and pay fixed charges for goods and services bought from other public companies.

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4. The deregulation of prices is aimed at improving

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the efficiency of resource allocation. Until now this function has been performed by central plans which crudely ration goods among firms. State companies have had no incentive to maintain or improve efficiency because their input rations bore no relation to performance. As a result, companies annually have produced large quantities of low quality goods which can only be sold at below cost. Many firms have failed to cover the costs of production and must be supported by state subventions. Company deficits and below-cost urban food prices now require subsidies which absorb roughly one-third of the national budget.

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5. In conjunction with a restructuring of prices and wages, the Party will also reduce direct state control over the production by public enterprises through confining central planning largely to heavy industry (e.g. steel and producer goods) and military products. Consumer goods industries (e.g. textiles, clothing and small appliances) are to set their own output targets with the guidance of, as opposed to direct planning control by, the state. Although the operations of heavy industrial companies appear to be largely exempt from immediate reform, output from some of these firms may be sold at decontrolled prices, once quotas called for by central state plans have been met. (CONFIDENTIAL)

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6. The Party has been experimenting with reform measures in some selected industries since 1979. These have had mixed results, however, because local managerial authority over economic factors was too limited and decisions were often countered by various elements of local and regional bureaucracies. The new and more general guidelines appear aimed at enlarging the authority and decision-making power extended earlier and at trying to reduce the ability of the bureaucracy to meddle. Since deregulation of state companies will remain limited, management will still have to contend with continuing interference from some regulatory elements of the central bureaucracy.

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7. Conflict between company management and the central bureaucracy may arise as soon as firms attempt any fundamental restructuring of their costs and prices and could affect the pace of reform. New product lines and better services will frequently require additional or improved resources and these will raise costs. The ability of management to meet higher costs by cutting the size of the work force may be resisted by a bureaucracy mindful of existing urban unemployment and anxious to avoid increasing discontent. Managerial attempts to reduce wage costs by relying on incentive payments and trying to cut current

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large fixed-income portions of take-home pay will be resented by workers and again opposed by a bureaucracy wary of allowing any general fall in real incomes. With such limits, many managers will likely resort to covering increased costs by raising revenues through higher prices. To the extent that price deregulation contributes to inflationary pressures, the authorities may back away temporarily from reform measures. (CONFIDENTIAL)

8. The decision to shift the main focus of reform from the rural to the urban economy has probably met strong opposition from powerful traditional socialist elements in the Party and army who view control over resource allocation as a political prerogative. They have not liked the powers of resource allocation allotted farmers but have grudgingly accepted them because they did not extend to price setting in the state sector and did not affect limited portions of the engineering industry. They will dislike new proposals to share price and wage setting powers with urban managers, not only because the proposals affect a substantial range of state prices immediately, but because ultimately they may affect a growing quantity of resources.

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9. Limitation of the reforms to consumer goods

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industries reflects the realization of reform supporters that, initially at least, they must restrict their program to areas that are manageable from the perspective of both administrative and political difficulties. By excluding most of the engineering industry (including divisions that manufacture trucks, locomotives, ships, machine tools, robots and aircraft), the supporters of reform have sought to mollify the opposition of traditionalists who recognize that this industry is one of the master keys to China's current and future economic development and merits special consideration. It is doubtful that this tactic of the reform supporters will allay for long the objections of the traditionalists who know that if the restructuring of light industrial companies is successful, greater efficiency here will create the financial resources for re-equipment. Demand for new equipment will be partly met by expanded import programs, but much equipment will have to be made domestically by heavy industry. In spite of any reassurances from reform supporters, traditionalists will fear that reforms may radically change the mix of heavy industrial output, threaten to realign the productive structure and exert inexorable pressure for significant changes in fundamental policies and control.

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10. The Party intends that the primary content and timing of reform measures be considered at a national conference scheduled for September 1985, when the key goals of the Seventh Five-Year Plan, 1986-1990, are to be discussed and adopted. Reform supporters expect that currently envisioned restructuring of the urban economy should basically be accomplished in about five years. Resistance from opponents on matters of principle and the problem of finding workable mixes of programs to promote efficiency will make the period difficult. A factor favouring reform is the knowledge, among city and town workers, of the remarkable growth of production and income within the past five years in the countryside and the hope that similar growth can be achieved in urban areas.

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