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China's New Economic Policy

by Armin Bohnet and Günther Jaehne, Giessen*

China's new economic policy made headlines in December 1984 when a leading article in the People's Daily expressed the previously unthinkable opinion that the teachings of Marx and Engels could not be expected to solve all of China's present problems. What have been the main characteristics of the reform, which began five or six years ago, and how should its results so far be assessed? What are the prospects for the future?

The debate that began after the end of the Cultural Revolution and the death of Mao Tse Tung on the subject of China's past and future socio-economic development grew into criticism of the Soviet-style economic model taken over from Moscow. By 1979 the Communist Party of China had already developed far-reaching reform ideas, which were gradually implemented in experimental plant in a number of provinces during the years that followed. These gave factory managers greater freedom of action and wider responsibility for matters such as the generation and use of profits. In subsequent years these rights were placed on a broader footing and the reform policy was extended to further sections of the economy.

The decisive breakthrough occurred on the land, however. The decollectivisation of agriculture and the introduction of the system of personal responsibility for the newly created family businesses led to a vigorous upturn in farm production. This made it necessary to expand the urban markets for agricultural produce and create the conditions for meeting the farmers' rising demand for producer goods and industrial consumer articles.

China's political leadership has now clearly recognised this requirement; the decision of the Central Committee of the Communist Party of 20th October 1984 on reform of the economic system laid the emphasis of further reform on the "urban economy". The Party leadership considers that the reforms made so far point in the right direction but do not go far enough. The reforms will revolve around the enterprise and will therefore lay the foundations for a new business policy, the main tenets of which are:

□ To develop and strengthen urban enterprises by greatly extending their powers of decision and responsibility for their actions. The socialist system of property ownership will remain broadly intact, however. In other words, drawing explicitly on Karl Marx, a distinction is made between formal property ownership and the actual allocation of powers of decision and action (Central Committee decision of 20th October 1984).

□ To extend enterprises' powers of decision in the following areas: the planning of current production within an approved product range; the procurement of raw materials and auxiliary products; the recruitment, election or dismissal of management personnel; the marketing of goods, including the pricing of goods for sale; the execution of investments financed from retained funds or from external resources.

□ To retain state responsibility for decisions of importance for the overall development of society. This applies in particular to the appointment, confirmation and dismissal of directors at around 3,000 large state factories, the establishment, relocation, merger or closure of enterprises and changes in plants' production patterns (Central Committee decision of 20th October 1984).

□ To strengthen the free market content while at the same time switching from the imperative to the parametric and/or indicative control of enterprises by the state. Any state plans that continue to be drawn up will therefore be achieved less and less by means of binding plan directives. Their place will be taken by economic instruments or monetary incentives designed to induce businesses to behave in the way the supervisory authorities wish.

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☐ To reward workers and enterprises according to performance, thus moving away from the long-standing principles of egalitarianism and the "common rice bowl".

☐ To establish an "organic" co-existence between different forms of property ownership. State-owned and collective enterprises will continue to be the predominant form in the urban economy, but individual ownership will be accepted as a necessary complement to community ownership, particularly in small businesses, trade and the services sector.

From these basic principles, it can be deduced that the most important areas for reform of the urban economy are:

☐ reorganisation of the financial system at the enterprise level and above;

☐ reorganisation of production rights;

☐ reform of the price system and the development of new forms of competition;

☐ establishment of a performance-oriented employment and incomes policy.

The Urban Economy at the Focus of Reform

It is difficult to distinguish the "urban economy" precisely from the rest of the economy, because such a distinction can be made only partly on the basis of the political division into towns and villages (rural regions). For example, many Chinese towns, such as the cities of Beijing and Shanghai, have jurisdiction over areas that are distinctly rural with a population employed predominantly on the land.

On the basis of the population census of 1982, the urban economy comprises around 2,900 towns with about 206 million inhabitants, or 20.6 % of the total population. The number of enterprises in these urban areas is put at more than 1 million, employing a total of 80 million workers; they include firms engaged in construction, transport and services as well as industry.

Industry has the greatest economic weight within the urban economy, as can be seen from the fact that the taxes paid by this sector and the profits it transfers to the Treasury constitute more than 80 % of the state's revenue. However, the urban industrial enterprises are not only the largest source of central and regional budgetary funds, they also account for the greater part of production nationwide. Using Chinese methods of calculation, industry generated 55.1 % of gross national product in 1983; the industrial plant of 232 cities alone produced about 75 % of total industrial output in 1982.

Chinese sources give conflicting figures for the number of industrial plant, the range being from 380,000 to more than 400,000. According to official statistics, the number has more than doubled since the days shortly before the Cultural Revolution, rising from about 158,000 in the mid-sixties to 388,000 in 1982. It is remarkable that more than 95 % of them are listed as small units, although it should be noted that according to Chinese criteria factories with 600, 800 or even 1,000 workers are still classed as small. The justification for this probably lies in the fact that these enterprises can still quite definitely be regarded as small in terms of turnover and capital resources. By contrast, large enterprises numbered 1,584 in 1982 and accounted for only 0.4 % of the total.

Structural Characteristics of Industry

The classification by branch of activity reveals a surprisingly large number of firms, presumably mostly small in size, in industries that are dominated by medium-size and large enterprises in developed economies; for example, there are about 102,000 enterprises in the engineering sector, more than 50,000 in the building materials industry and over 24,000 in the chemical industry, including 1,300 engaged in the production of mineral fertilizers alone. The question inevitably arises as to the reason for this relatively large number of industrial enterprises. It is clearly only partly historical, as the increase in numbers since 1949 shows. A possible explanation may lie in the numerous enterprises established under the policy of rapid industrialisation pursued since the founding of the People's Republic of China. The level of technological development is probably also an important factor; the continued prevalence of artisanal production simply requires a large number of labour-intensive, low-technology workshops.

A further explanation can be found in the deep-rooted regionalism in China. Regions and areas of jurisdiction, such as the provinces of today, have always striven for autonomy, including economic self-sufficiency. Even in modern China this has prevented the development of an integrated economy and led to wide differences in the economic structure and development of the various regions. The coalescence of the regions into a uniform national market practising the division of labour has also been impeded so far by the inadequacies of the infrastructure, especially the transport system, and by the thinking in terms of economic branches and departments adopted from the Soviet Union.

As far as the form of property ownership is concerned, state enterprises in industry came to 86,000 in 1982,

only 22 % of all enterprises, but they produced 77 % of gross industrial output, a figure that underlines the economic importance of this type of enterprise. The largest group of industrial enterprises – around 302,000 units, of which more than 186,000 are run by the rural production brigades – are the collectives, which account for 22 % of gross industrial output. The proportion of co-operatives differs from one industry to another, however. Collective enterprises are particularly prevalent in the consumer goods industry, where they represent 83 % of the 73,000 enterprises.

The number of privately managed industrial plant is still insignificant, at about 600. However, their importance may increase as a result of the recent practice of leasing small and often badly managed state factories to private individuals and newly established co-operatives. Private enterprises already play a significant role in trade and services, where they have not only improved the retail supply but have also had a beneficial effect on competition between enterprises in various forms of ownership.

Industry's Poor Performance

Chinese industry is technically backward and most of its plant are seriously outdated. One of the Party leadership's main aims in reforming the planning and management of industry is therefore to close the technological gap between China and more developed economies, which widened further during the self-imposed isolation of the Cultural Revolution and which Chinese data now put at between 20 and 25 years. For example, in Shanghai, China's largest industrial centre, about 80 % of all machinery and equipment in the textile industry and other branches producing consumer goods is nearly 40 years old and most of the remaining plant was installed between 15 and 25 years ago.

The obsolescence of China's industrial technology is due partly to the fact that in the past enterprises had practically no possibility of using profits and depreciation to modernise their plant. As a result of the so-called budget principle, only a limited amount of these resources could be retained as reserve funds; the remainder all had to be transferred to the Exchequer, which allocated them mainly to finance new enterprises, if they were used for investment at all.

Technical obsolescence has a number of adverse consequences; in the consumer goods industry, for example, a combination of obsolescence, a lack of competition and a lack of market information has led to a situation in which 60 % of all goods produced are obsolete in terms of utility and are virtually unsaleable. A

further nationwide consequence is that industry's consumption of energy and materials is above average and the cause of severe avoidable environmental pollution.

New Ways to Raise Capital

At the present pace of development, China's relatively underdeveloped economy has a massive capital requirement that can no longer be met by the traditional method of capital allocation owing to the weak financial capacity of the state and of the economy. This not only stunts the growth of many smaller private enterprises and co-operatives but also jeopardises the realisation of centrally-planned building projects in key areas of the economy. As a result, major projects in the fields of energy, raw materials and transport have had to be scaled down or spread over a longer period in recent years.

China is therefore seeking new ways of providing the economy with both financial and physical capital. Attracting foreign capital to finance the process of industrialisation is seen as one possibility; lack of space precludes detailed treatment here of the broad and complex subject of the procurement of foreign capital. At the same time, however, the economic reformers are making a concentrated effort to develop new procedures for allocating capital domestically and to tap additional domestic sources of funds.

One important reform consists in abolishing the siphoning-off of profits, which was practised up till now, and the allocation of monetary capital out of the government budget coupled with control by the authorities over investment. On 1st June 1983 their place was taken initially by profit-sharing, whereby enterprises' profits were apportioned between the enterprise and the state according to a scale determined by the authorities. At the end of 1984 this system was replaced by the general taxation of profits. At the same time it was laid down that enterprises could use their retained profits largely as they saw fit. Nevertheless, the arrangements for taxing profits remain highly complicated, comprising a general profits tax, a resources tax to syphon off above-average profits due to locational or technical factors and a profits regulation tax to cream off excess profits caused by favourable cost/price relationships.

Retained profits are probably spent mainly on investment in the replacement or expansion of plant, on social security measures at the enterprise level and on wages and bonuses. However, economic activities unrelated to those of the enterprise itself can also be financed out of profits, such as participations in other

enterprises. It remains to be seen whether and to what extent this will lead to mergers.

Capital requirements that exceed enterprises' own resources are to be financed mainly through bank loans. To this end, the banking system was thoroughly reorganised in 1983 and 1984. Besides the People's Bank of China, which has responsibility for monetary and credit policy and the supervision of the other banks, there are now six further banks which perform certain special functions. However, the special nature of these institutions means that they can continue to act as monopolists in their allotted fields. More far-reaching reforms are planned in order to change this, and in some areas action is already being taken. The measures range from the authorisation of co-operative banks to the issue of securities similar to shares to finance the formation and expansion of collectives. Consideration is even being given to the establishment of a comprehensive, effective capital market.

In recent years the rather restrictive credit policy has been eased, so that enterprises now have better opportunities to raise external capital. However, continuing economic growth in all areas and the increasing activity of private individuals in trade, crafts and services have also perceptibly increased the demand for finance. State enterprises can raise the capital they need from the new special banks, albeit at interest rates that now vary according to their creditworthiness and the purpose of the loan, but private enterprises and co-operatives often have difficulty obtaining loans from the state banks. Hence, they often ignore the banking system and raise investment capital themselves, for example by issuing bonds to members of their workforce. Communes have also recently begun to use the liquid funds accumulated by private

individuals by issuing debt certificates to finance public projects.

The partial removal of business and communal investment from state control and the existence of several ways of raising capital has now led to keener competition between the various consumers of important commodities and raw materials. This has meant, amongst other things, that key centrally-planned projects have not been completed on time and that factories have had to forgo urgently needed replacement or rationalisation measures even though the necessary finance has been available. China's economic reformers will have to consider how they wish to tackle this problem of the enterprises' "appetite for capital", which is also encountered in other socialist countries, and the economy of scarcity associated with it.

Redistribution of Powers over Production

Since the foundation of the People's Republic of China, production in state enterprises and to a large extent in co-operative enterprises was mostly planned by higher authorities and controlled by binding, detailed production quotas. Introduction of the principle of separate responsibility and the right for enterprises to retain part of their profits gradually gave enterprises greater power to determine current production and investment.

In practice, the extent to which responsibility for production decisions is devolved will vary. There will be areas in which enterprises will be able to decide for themselves which products to produce, when, how and in what quantities to produce them and where to sell them. This arrangement will apply in particular to everyday articles, handicrafts and services.

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V E R L A G W E L T A R C H I V G M B H - H A M B U R G

A second group of goods will continue to be produced according to detailed and binding quotas set by state planning authorities. These are goods of crucial importance for the development of the economy as a whole and for the standard of living of the population, such as coal, wood and important chemicals. According to official information, this category comprises about 100 positions.

For a third group of goods and services, the largest in terms of numbers, production decisions are to rest ultimately with enterprises, but the authorities intend to influence them by means of a system of monetary incentives so that they also take account of the state's aims with regard to development and structural policy. These incentives can be set at a uniform level for the economy as a whole, as in the case of the general profits tax. However, production will be governed primarily by specific parameters set or controlled by the authorities, such as product prices, product-related subsidies and taxes or interest rates and credit volumes differentiated according to the purpose of the loan or the sector.

All things considered, it can be concluded that when the planned reforms have been completed China's urban economy will be a mixed system, with planning and market forces existing side by side, though in different proportions depending on the sector.

The state will continue to play a leading role in determining activities that impinge upon the structure of the economy. These include the exploitation of natural resources, the introduction of technical know-how through modernisation, the realisation of key investment projects in the fields of energy, transportation and important intermediate products and economic and technical co-operation with other countries. In practice, enterprises have freed themselves from state regimentation even in these areas and have taken initiatives of their own, especially with regard to contacts abroad.

It is worth noting the pointers to the growing role that provinces and, more especially, municipalities are to play in co-ordinating the development of enterprises and regions. It is intended that regional and even local authorities will be given greater scope to initiate and influence state development programmes. The first visible results of this policy are the establishment of special economic zones in China's coastal regions, the creation of regional planning and co-ordination centres (for the Jangtse delta, for example) and the elevation of the municipalities of Chongqing, Wuhan and Shenyang to the status of provinces for the purposes of

economic policy. The plan to remove all engineering enterprises from the control of the Ministry of Machine Industry and place them under the jurisdiction of the major municipalities from the end of 1985 onwards should also be seen in this context. The aim of the change is to increase the enterprises' powers of decision and at the same time achieve greater flexibility of production.

In summary, it is clear that a number of very different instruments for co-ordinating production will operate side by side once the present reforms have been completed. This is bound to have an effect on the efficiency of production.

Price Reforms and Heightened Competition

China's economic reformers have recognised that continuation of the price policy pursued hitherto would largely prevent attainment of the country's reform objectives. They themselves describe the existing price "system" as irrational and see its reform as the key to reform of the entire system of economic planning and management.

The action required can be deduced from the functions that prices are to perform in the new system of economic management. Their most important role will be in the assessment of enterprises' performance, the achievement of mutually compatible patterns of production and consumption – especially control of the exchange of goods between urban and rural regions – encouragement for the introduction of new manufacturing methods and products and the orientation of individual reward to performance.

To meet those objectives, the following measures are planned: the adjustment of prices in order to match supply and demand; increases in the prices of raw materials and important intermediate products; stabilisation of the prices of products in industries further downstream by granting adjustment subsidies and tax concessions; reductions in limited-term food subsidies coupled with reductions in producer prices or increases in final consumer prices; increases in nominal rural and urban incomes sufficient to maintain their real value.

As well as adjusting prices, the authorities will restructure the system of price-setting powers. The previous strongly centralist system of price formation and control is to be replaced partly by a more flexible system of pricing. However, current intentions do not seem to be to transfer responsibility for prices entirely to enterprises except in a few industries. The prices of most products will only be able to fluctuate within officially determined limits. On the other hand, reports

on price setting in practice show that official price controls have only limited effect, especially in the cities; for example, actual prices often diverge from the fixed prices or price bands set by the state.

The overall impression is that the reformers still have reservations about allowing the spontaneous market forces of supply and demand to have greater influence over price formation. This reluctance may stem from fear that inflation will become difficult to control, but it may also be due to deep-seated reservations about allowing price determination out of the hands of the state. It must therefore be expected that many prices in China will continue to be state administered prices in the immediate future, with all the problems that can entail.

Apart from the irrationality of the price system, there is another reason why many prices fail to perform their allotted function in China, namely the lack of competition on the supply side. This absence of competition is particularly noticeable where plant have been amalgamated or the manufacture of new products has been concentrated in a single factory as a result of the periodic centralisation campaigns, but it is also apparent where a market displays the characteristics typical of an economy of scarcity, in other words insufficient supply at a given price.

The economic policy-makers in Beijing have recognised the disadvantages of this situation and have now taken the initial steps towards deconcentration, which they expect to bring greater competition between enterprises as well as an improvement in production planning. A few examples have already emerged: in future China will have several airlines that will compete with one another in at least certain fields; a third metals marketing company has been set up to market ironmongery; the single-tier banking system has been decentralised and split into two tiers; and finally, it was recently decided to abolish the state trading monopoly in cereals, to convert the 35,000 or so state purchasing companies for farm produce into co-operatives and to allow them to compete with one another on a limited basis.

There is already increasing competition in many other fields and at the "grass roots". Examples are the removal of administrative, trade and labour market barriers between the provinces, the increasing flow of goods and labour between the land and the "urban economy", the growing competition between state, collective and private enterprises in commerce, transport and services and the many direct economic and business relations that individual Chinese enterprises and provincial governments maintain with

contacts abroad. Although still in its infancy, there are signs that competition will become more widespread than has been seen hitherto in other socialist economies.

Performance-oriented Employment and Incomes Policy

Greater autonomy has given management the right to base their staffing and incomes policies on commercial criteria for the first time. The official reform concept will allow them to engage and dismiss workers as operating requirements dictate and to gear wages to individual performance. Although these rights may not or cannot be exercised to the full at present – for example, the dismissal of employees is a complicated process – they do represent a fundamental departure from the previous principle of income equalisation and guaranteed employment.

Extensive staff changes must be made in most of the 400,000 enterprises before these aspects of the reform can make their full impact, however. China's greatest problem at the moment is the dearth of skilled workers and factory managers. The situation is exacerbated by the uneven regional distribution of qualified workers.

If the factories are to be managed in accordance with the "modern scientific methods" the Party desires, the first step must be to replace several hundred thousand managers at all levels of management. Enterprises were previously "appendages" of administrative bodies and were run by them or by the relevant Party secretaries, so that the present management corps is grossly over-age and hence ill-acquainted with modern management techniques. Beijing believes that the reason why many enterprises still run at a loss can be attributed to mismanagement in 70 % of the cases. The management training courses that have been established throughout the country, in some instances at the universities and mostly with the assistance of institutions from "capitalist" countries, are designed to train a new generation of managers. Ideally, a manager of the modern school should be as young as possible but with professional experience, sympathetic towards reform, strong-willed and if possible a university graduate.

It is remarkable that in all but the important state enterprises factory management posts are awarded on the basis of staff elections, with the relevant authority retaining the right to confirm or reject appointments. Under the system of responsibility practised, the pressure on factory managers to produce results is evident in the fact that their "term of office" usually lasts

only a few years and that during that period they must also provide regular proof of their success.

The proportion of industrial workers who are only semi-skilled is an extraordinarily high 70 % in China, compared with 4.7 % in the USA. As a rule, only a minute percentage of a factory's workforce will have technical qualifications. Courses are now being provided on a wide front by the state and by enterprises to improve training and occupational qualifications at this level too. The prospect of higher wages and the increasingly common practice of holding entrance examinations for job applicants are creating a strong incentive to attend basic and advanced training courses.

The aim of the reform of the wage system is to change over from income equalisation to payment by results. Wages will be determined on the basis of individual performance and the factory's operating profits. Workers who produce poor work and display a lack of discipline risk deductions from their pay or even dismissal in extreme cases.

In practice, however, the powers of factory managers still seem to be severely limited in this respect. This can be deduced from the fact that the national wage total, the rate of growth in salaries and the level of basic incomes in the factories continue to be laid down centrally. On the other hand, management does have ways of paying more than the norm, mainly in the form of bonuses, which are now very popular in Chinese industry. The original limitation of bonuses to a maximum of three months' salary on socio-political grounds has now been abolished because workers reacted by reducing their output.

Results and Problems

The organisation of the Chinese economy and its co-ordination mechanisms have undergone remarkably far-reaching and rapid change since 1979. In the light of the results achieved, the reforms carried out so far can be regarded as successful, even though the economic advances cannot be ascribed entirely to them alone. The introduction of corporate responsibility and the right for enterprises to use part of their profits themselves has enabled many concerns to reduce their operating costs. By comparison with the past and with countries at a similar stage of development, China has achieved extraordinarily high rates of growth in gross national product and especially in the production of consumer goods. The supply situation has improved markedly, particularly at the consumer stage, and the standard of living of most of the population has risen, though to

varying degrees. Not least important is the fact that China's increasing openness has laid a solid foundation for orienting the economy more strongly towards the world market.

The positive overall assessment of the reforms cannot, however, hide the fact that old problems remain and new ones have arisen. Let us briefly list some of the most important problems that remain to be solved:

□ The principle that an enterprise has responsibility for its own operations is working imperfectly because some powers of decision still have not been transferred to management. The same applies if state institutions interfere in the day-to-day activities of the enterprises. The result is a blurring of areas of competence, so that it is difficult to establish where responsibility for any mistakes lies.

□ The use of both planning and market forces as dual instruments of control is a cause of permanent conflict between the objectives of the state and those of the enterprise. If central production and resource allocation plans are to have priority and to be enforced by government directive – as will continue to be the case for important raw materials and capital goods – this means curtailing the opportunities for purchases in the market by enterprises that have no allocation. Conversely, procurement, production, sales and investment planned on an individual enterprise basis can hinder or even prevent the achievement of official economic plans. This may be seen in the field of investment, for example, where it has not yet been possible to curb the growth of heavy industry, thereby permitting more rapid development of the consumer goods industry, or to reduce the proportion of "productive" investment in favour of "non-productive" investment.

□ In recent years, state sponsorship of large-scale investments and the establishment of new enterprises has had the effect of further widening the technological gap and the cost differential between large modern factories and plant using traditional production methods. This is undoubtedly one reason why on the one hand many enterprises generate very high profits while on the other one-fifth of state enterprises still operate at a loss and are dependent on payments from central or provincial funds to make up the shortfall. This situation of above-average profits on the one hand and payments to offset losses on the other undermines the authorities' efforts to persuade workers to think in terms of performance and enterprises to bear responsibility for their operations.

□ The extent and direction of the planned price reforms are not such that they can fully eradicate the absurdities

in the price system. One problem that has yet to be solved stems from the fact that trade in goods and services has largely been liberalised and yet prices are fixed by the state. This leads to market disequilibria and ultimately to the growth of unofficial or black markets. The first signs of this are appearing in China's consumer goods sector.

Another problem is evident in the fact that present prices are burdened with too many functions. Most prices are still set by the state, and yet they are expected not only to bring supply and demand into balance but also to provide incentives to adjust China's outmoded product range to new technologies and changes in demand. To do that, they would have to be given greater freedom from official control than has been planned hitherto and be left to market forces. Only then will it also make sense to use profit as the all-embracing criterion for the performance of enterprises and as a yardstick for rewarding workers.

□ As far as the labour market is concerned, the reforms should bring a considerable relaxation of the previous rigid system of state job allocation, guaranteed employment and egalitarian incomes policy. On the

other hand, full implementation of the possibilities opened up by the reform would create difficult problems. It must ultimately be decided whether company managers are really to have complete freedom, in other words responsibility, to decide on the size and composition of their staff. Given the widespread serious overmanning, especially in state enterprises, there would then be a considerable shake-out of labour, further increasing the already large number of workers seeking employment in the towns. The problem is compounded by the growing pressure on small and medium-size towns caused by workers leaving agriculture. A large proportion of those seeking employment could certainly be absorbed in the expanding collective and private enterprise sectors, but a substantial number would still remain.

□ One question that cannot be answered at present relates to the prospects of successfully raising the standard of vocational training and expanding the programme. In particular, it is impossible to judge whether the comprehensive measures that have been put in hand are sufficient to improve the general level of occupational qualifications as much and as quickly as

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V E R L A G W E L T A R C H I V G M B H – H A M B U R G

Chinese experts consider necessary to achieve the country's modernisation goals.

Prospects

There is a clear thread running through China's economic policy of the last 5 or 6 years. It has been shaped by the attempt to reduce state interference in the day-to-day running of the economy, increase the independence of producers, arouse their interest in increasing output and achieve the objectives of the Party and of the Government mainly through monetary incentives and penalties. This policy was shielded from attack by the party leadership's repeated anti-ideology campaigns, which reached their peak to date in a leading article in the *People's Daily* in December 1984 on the significance of classical socialist thinkers for solving present-day economic and social questions. Although it was toned down later, the article expressed the previously unthinkable opinion that the teachings of Marx and Engels could not be expected to solve all of China's present problems. Hence, there should no longer be any major ideological barriers to continuation of the economic reforms, unless there were a fundamental change in the balance of political power.

The Chinese people's traditional manner of thinking and behaviour could prove an obstacle to reform, however. At present the doctrine of moderation and the middle path derived from Confucian teaching is just as responsible for impeding individual initiative as are the adherence to customs or the refusal to acknowledge economic and technical innovations. This is compensated by the Chinese people's fabled ability to prise economic success from difficult situations, which is still evident today.

One aspect that economists find hard to assess is the question of the acceptance of the reforms – and their consequences – by the Party and the Chinese people. The driving force behind the reforms is undoubtedly the senior leadership of the Communist Party of China, under the intellectual leadership of Deng Tsiaoping. However, whether and to what extent the policy has the backing of the majority of the Party's 40 million members, who make up just over 4 % of the total population, is probably not entirely clear even to the Party leadership itself.

As is usual in communist countries, only the advocates of reform are getting a hearing in the Chinese media at present. The political position of opponents and their arguments can be gauged only indirectly from the nature of the official polemics against them. It is noticeable that the views of "leftists" critical of the

reforms are being attacked even in publications intended for consumption abroad. Western observers believe they are still remarkably strong in the middle and lower ranks of the Party, especially in the less prosperous provinces.

The same is probably true of the representatives of the administrative machine; when re-appointing managers in the factories, for example, the officials responsible for cadre affairs not infrequently favour older or "cautious" officials of the Party or the administration rather than younger persons or those sympathetic towards reform. It is even more uncertain how the various ranks in the army leadership judge the reforms and whether they support them. Finally, it should not be forgotten that both the economic reforms and China's "opening to the world", with all the social and psychological consequences they may entail, must be "digested" by the Chinese people.

Up to now, the reformers and their actions have won approval and legitimacy in the eyes of broad sections of the population on the strength of their success. However, the Party itself has given the Chinese high expectations for the future, with regard to improvements in the standard of living, for example. The predominantly favourable mood could turn to rejection if setbacks occur, if the economy perhaps grows more slowly or if the public becomes more acutely aware of the social consequences of many of the measures, such as social differentiation or unemployment as a result of the incomes policy geared towards performance.

Whether the reform ideas will ultimately win the day is not simply an economic problem or a question of political power; it is also a question of changing the consciousness of the Chinese people. The first task will be to dispel the continued mistrust of many members of the Chinese intelligentsia, particularly older people and those harmed by the Cultural Revolution, who are sceptical about the durability of the present policy of reform. As for the younger generation of Chinese now entering positions of political and social responsibility, the omens appear favourable. Despite some reawakening of Confucianism, this generation is probably already much more performance-oriented than their parents. Finally, the intense wish of many Chinese for a better supply of consumer goods should not be underestimated. To achieve that objective, the Chinese will undoubtedly make a greater effort at the workbench.

In general, therefore, the prospects of a longer-term continuation along the present road to reform can be regarded as favourable.