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China's Industrial Management Reforms: Rough Road Ahead

A Research Paper

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A Research Paper

This paper was prepared by [redacted] 25X1
[redacted] Office of East Asian Analysis. Comments 25X1
and queries are welcome and may be addressed to
the Chief, China Division, OEA [redacted] 25X1
[redacted] 25X1

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China's Industrial Management Reforms: Rough Road Ahead

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Summary

Information available as of 27 March 1987 was used in this report.

Chinese officials increasingly have recognized that modernizing industrial management is a precondition for overcoming the inefficiency, uneven product quality, and poor use of equipment and technology that characterize Chinese industries. Beijing made management reform an integral part of its economic reform program in 1984, and in 1986 called for enterprise management to be evaluated on the basis of three criteria: improved product quality, reduced material consumption, and increased productivity. In November 1986, Premier Zhao Ziyang stated that invigorating major enterprises through managerial reforms would be the focus of China's economic restructuring in 1987.

To create a new industrial management system, Beijing is promoting greater enterprise autonomy and more responsibility for factory managers. Measures such as reducing or eliminating mandatory state production plans, phasing out state provision of raw materials and investment funds, and allowing enterprises to retain more of their earnings are intended to shift the government's role to indirect guidance of industries as a whole. Within the factory, reforms such as the "factory manager responsibility system" call for directors to have full authority over production, personnel, and administration; managers will be rewarded on the basis of the enterprise's profits and losses. Beijing also is testing other more radical management reforms, such as allowing individuals to lease factories after posting personal property as a guarantee, or permitting managers to issue stock to raise capital. We believe, however, that the factory manager responsibility system will be the mainstay of China's management reforms for some time.

Many of the showcase factories instituting management reforms have achieved impressive results in areas such as technology use, quality control, and stimulation of creativity. This suggests that the changes could improve the management, innovation, and productivity of Chinese industry if the leadership commits itself to a long-term reform program in this and related sectors of the economy.

However, resistance to reform is strong and is coming from several directions. At the local level, party secretaries and administrative organizations have little motivation to accept management changes. The new policies often go directly against the interest of party and government officials by reducing their authority and, with it, their prestige and perks. Workers also resist changes affecting employment levels and wages.

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In addition, the renewed debate over political and economic reforms in the wake of Hu Yaobang's resignation has led to the reemergence of conservative economic themes—including calls for more state control—and criticism of enterprise management reforms. The ongoing debate reflects disagreements over the respective roles of party and government—an issue at the heart of management reforms. Failure to resolve the conflict among party, administrative, and factory management officials over their roles in production will prevent Beijing from instituting a permanent, new management system. Conservative criticism has already forced suspension of related economic measures—such as price and labor reforms—that are essential to factory modernization. Moreover, the debate probably will cause party officials to be even more recalcitrant about following reforms, and managers more hesitant about implementing them. These factors plus the sheer enormity of the task of modernizing one-half million enterprises suggest that, over the near term, management reforms will continue to bring improvements to industrial performance only at the margin.

The reforms, in any case, give managers only new responsibility and authority, but not the knowledge to handle the new opportunities. Current training programs—under both international and domestic auspices—reach only a small portion of the enterprises in need of management modernization, although Beijing is working to expand the effort. Since 1978, when Deng Xiaoping first asked the United States to establish the management training center in Dalian, four other training centers have been established with international assistance. A number of countries and foreign firms are also providing training through seminars, cooperative programs, joint ventures, and on-the-job experience in foreign factories.

The United States has generated considerable good will by being at the forefront in offering training to Chinese managers. Many of the graduates of the US-sponsored program at Dalian have been appointed to senior government posts, and Chinese leaders have expressed their appreciation for the quality of US management programs.

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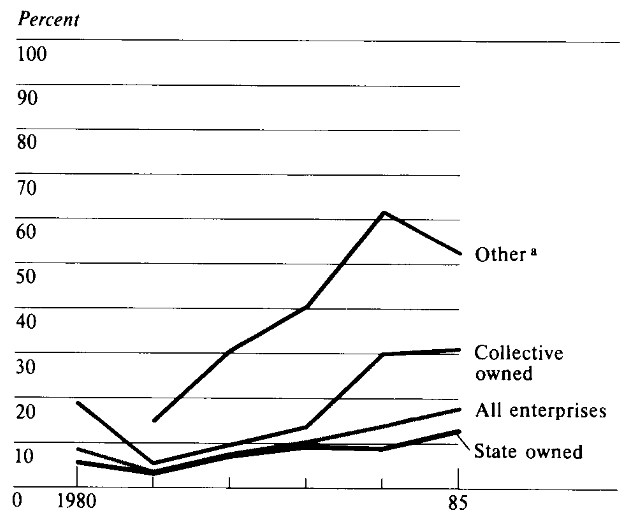
An Urgent Need for Reform

Chinese and foreign observers alike have for years acknowledged that poor management in Chinese factories has been a major cause of China's low productivity, ineffective use of technology, and poor product quality. As part of its larger economic reform program—aimed at improving performance by gradually adopting a system combining central controls, free market forces, and microeconomic incentives—China began experimenting with management reform as early as 1979. The issue has remained a central one for economic planners. For example, in early 1986, Lu Dong, Minister of the State Economic Commission, called management reform extremely important to the overall economic situation and stressed the "urgent need to improve enterprise management." [1] And in November, Premier Zhao Ziyang stated that invigorating major enterprises through managerial reforms would be the focus of China's economic restructuring in 1987.

China: Growth Rates of Gross Value of Industrial Output (GVIO)



a Includes private, state-collective, state-private, collective-private, and foreign joint venture enterprises.

Source: *Statistical Yearbook of China*

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Creating a New Management System

Throughout most of China's industries, factory directors serve as government functionaries fulfilling orders from above. The state supplies raw materials to factories and tells managers what to produce, to whom to sell, and what price to charge. The factory party secretary approves production plans and appoints personnel; he even approves, in consultation with higher authorities, the appointment of the factory manager, who then manages "under the leadership of the party committee."

Beijing has for some time publicly recognized the problems inherent in this system. Fulfilling the plan often becomes the goal, with little need to consider whether the product meets the needs of consumers or whether the enterprise is profitable. Factory directors have little authority or incentive to improve the factory's performance by increasing output, upgrading quality, or adopting technological advances. Determining even the costs of production is difficult, given the state-controlled prices of supplies and finished goods. At the national level, the subsidies to and the poor performance of state enterprises constitute a

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major drain on government resources. In the past, China has sought to improve enterprise performance by stressing capital investment, and, more recently, investment in technical upgrading to increase enterprise output. These attempts to solve problems by "throwing bricks at them" have increased state investments, but poor state enterprise performance, rapidly rising state deficits, and mounting state enterprise losses have underscored need for management reform (see figure). China's State Statistical Bureau reported that the number of deficit state enterprises rose from 10.5 percent in 1984 to 17.6 percent in 1986.

Redefining Industrial Priorities

Beijing has tried to refocus industrial priorities on correcting management problems. Major economic reform documents issued in 1984 established guidelines for creating a new socialist economic structure in which enterprises can respond in a competitive way to market signals. The State Council last year further specified that enterprise management is to be evaluated on the basis of three criteria: improved product quality, reduced material consumption, and increased productivity. It also established targets in each of these categories that enterprises must try to reach during the Seventh Five-Year Plan (1986-90).[2] Since July, Vice Premier Li Peng and others have urged use of a fourth criterion—how well a factory uses and manages its equipment.

The State Council documents called for industrial upgrading to begin in machine building, electronics, iron and steel, nonferrous metals, chemicals, textiles, and some light industries. Enterprises are to adopt new management systems, introduce advanced management techniques, and use advanced technology to reduce waste and improve quality. Beijing says other sectors, such as transport, post and telecommunications, service, and building industries, also will work out ways to strengthen enterprise management.

The Reforms: Changing the Way Factories Are Managed

To achieve these goals, Beijing is trying to reduce direct involvement of government and party officials in factory affairs and give managers responsibility for enterprise performance. Although the reform program continues to evolve, the basic program appears currently to have two main tenets:

- *Enterprise Autonomy*. To give enterprises greater autonomy in responding to market signals, Beijing is shifting the government's role in industry from direct involvement in production decisions to a more indirect role of planning, coordinating, and supervising industry as a whole, according to published reform documents. The reforms call for the state to reduce mandatory production plans, provide a smaller portion of raw materials for production, and eliminate interference by government officials in factory affairs. A key area of change is the financial relationship between the state and enterprises. Beijing is reducing state-supplied investment funds; allowing enterprises to retain a larger share of their revenues and to decide how to use those earnings; and granting enterprises the right to sell overquota production at prices above state-set levels. 25X1

- *The Factory Manager Responsibility System*. This system—the heart of management reform within the factory—is designed to:
  - Establish the authority of the factory director as key decisionmaker within the factory.
  - Provide financial incentives for managers to improve factory performance. 25X1
  - Establish adequate checks and balances against abuse of managers' newfound powers. 25X1

The factory manager responsibility system is also Beijing's primary mechanism for redistributing power from party secretary to plant director. The system theoretically gives plant directors full authority to manage production, appoint and dismiss personnel, adjust and establish administrative systems within the factory, and reward or penalize workers and staff. Managers are rewarded on the basis of the enterprise's profits and losses. 25X1 25X1

Implementation of the management reforms began in 1979 with experiments in selected locations, which were gradually expanded until a backlash against the

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reforms occurred in mid-1985 and early 1986. Public reports that managers were abusing their decision-making powers proliferated; many were unwarranted attacks by party conservatives against innovative methods, although some instances of corruption were also uncovered. Such reports caused reformers to reconsider both the checks on a manager and the protections afforded managers against malicious criticism. Also, numerous problems during the period—excessive industrial growth, inflation, and skyrocketing investment—caused reformers to slow the reform program until they could improve macroeconomic control techniques, such as the use of taxes and interest rates, and deal with criticism by conservatives. Beijing renewed its push for modernizing management in mid-1986, when it publicly called for expanding the number and types of enterprises subject to management reforms during the Seventh Five-Year Plan (see inset on page 4). [redacted]

In practice the degree of autonomy accorded enterprises varies by industry, size of firm, and whether it is state or collectively owned. In general, the greatest autonomy is found in small, collective industries producing items not directly related to the national interest—a list of items that is apparently growing, according to Chinese and foreign observers. Nationwide, only about 60 major industrial products, such as steel, petroleum, and chemicals, remain under mandatory state production quotas. Industries that are major foreign exchange earners tend to have less autonomy than light industry. [redacted]

The factory management responsibility system is operating in over 40 percent of state-owned industrial enterprises, according to a Chinese State Statistical Bureau survey of 21 provinces. [redacted] implementation is spotty, however, as evidenced by a 1986 survey of 10 provinces, which found that only 20 percent of those enterprises practicing the manager responsibility system had fully implemented it. Nevertheless, numerous examples of improved enterprise performance under the system encouraged the leadership to extend the manager responsibility system to all state-owned enterprises by 1990. [redacted]

Experimental Measures

Official Chinese statements and US Embassy reporting show that other measures have been proposed, offering alternatives for increasing the managers' personal stake in the success of the enterprises, forcing them to consider the balance between the enterprises' immediate and long-term interests, and creating a stronger process for auditing and evaluating the managers' performance. For example, the Chinese official who says he devised the factory manager responsibility system has come to believe it does not give managers adequate tools to carry out reform and to counter party and local government interference, according to US Embassy reporting. This official is now overseeing experiments with a financial responsibility system that bases incentives for managers on owning stock in the enterprise (see inset on page 6). [redacted] 25X1

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Even more radical changes have been proposed, such as reducing state ownership of enterprises and changing the party role within the factory to a voluntary, unpaid position engaged in essentially extracurricular activities. Some Chinese have argued, for example, that the state must not only distance itself from management but must actually transfer ownership of its enterprises to managers and workers to motivate them to increase productivity. Many of these reforms are strongly opposed by party officials, however, and we believe the factory manager responsibility system—probably formalized by contracts that more closely link the managers' incomes to their factories' performance—will be the mainstay of China's management reforms for some time. [redacted] 25X1

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Creating a Trained Corps of Managers

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These reforms, at best, give a manager new decision-making responsibility and authority, but not the knowledge to handle the new opportunities and obstacles presented by the evolving economic system. Examples of managerial successes cited in the Chinese

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Chongqing: A Microcosm of Management Reforms

The course of management reforms in Chongqing captures the problems, trends, and progress seen in varying degrees elsewhere in China. One of the largest industrial cities in the southwest, Chongqing was among the first sites in China to experiment with management changes.

Early experimentation *began in 1979, when Premier Zhao Ziyang was in charge of the province. The experiment included over 100 enterprises by 1982; further acceleration occurred in 1984.*

A backlash *appeared in 1985, as exemplified by the case of the director of the Chongqing Rubber Belt Factory. After taking office in 1982, the director established detailed production plans and regulations. By 1985, the factory had risen from last to first place among the nation's rubber belt factories. But criticism by conservatives of the director's methods began to appear in the press, focusing on excessive use of funds to host a sales meeting at which potential buyers were entertained by singers. After an investigation, city authorities declared the charges unfounded and their faith in the director unwavering. Similarly, five managers of other factories were cleared of charges after city and party officials held public hearings.*

In a renewed emphasis on reform *in 1986, Chongqing took steps to eliminate some of the friction over implementation of the reforms. In May, the city government issued a regulation stipulating that factory directors cannot, without reason, be removed from their posts at the will of their superior departments. City officials announced in July that, to further resolve the "power struggle between administrative units and enterprises," 52 administrative companies changed their nature from administrative management to economic service organizations that provide marketing and other services.*

At present *in Chongqing, over 460 industrial enterprises operate under the manager responsibility system. According to Chinese press accounts, managers in these factories can appoint and dismiss assistants and decide production and discipline issues. Managers in 20 percent of these enterprises operate under a set term of service.* 25X1 25X1

More innovative reforms are also being tested. In the summer of 1986, Chongqing began advertising for a director to head the first factory to operate under a leasing arrangement, called the asset management responsibility system, that ties a director's salary to how closely he meets goals for production and capital gains. In September 1986, city officials announced that 20 state enterprises would implement the system. Chongqing also has loosened controls over technology supplies and major industrial materials, allowing managers to directly acquire needed inputs. Other reforms under way include encouraging enterprises to attract capital by issuing stocks and leasing some small state-owned factories. Chongqing's first stockholder-owned factory was established in September 1985, with 3.24 million yuan (US $880,000) invested by one state-owned company, three collectively owned enterprises, and individuals. 25X1 25X1 25X1

The role of the state has been reduced. Only those products essential to the national economy, such as iron and steel, remain subject to targets; only 12 percent of Chongqing's total industrial output value is produced under mandatory planning. 25X1

In the future, *in keeping with the State Council's July 1986 decision on management reform, the Chongqing party committee and government announced in September 1986 that the factory manager responsibility system was to be immediately implemented in all enterprises.* 25X1 25X1

When the manager of this Shenyang automotive company switched to leasing the state-owned enterprise, he used his expanded authority to increase profits 35-fold over a four-year period. [redacted]

press credit "gutsy" individuals who took charge, but many Chinese factory directors find the new demands incomprehensible. Foreign observers note that most managers, although conscientious and hard working, see themselves primarily as conduits for information from higher authorities to workers. [redacted]

Initial Steps for Improving Managerial Skills
China initially emphasized the need to put better educated, more qualified persons in top factory positions. As part of a national campaign to rejuvenate industry by replacing older officials, Beijing instituted mandatory requirements in 1982 to abolish the lifelong term of office and began stressing the importance of higher education and technical background in selecting replacements. As a result, a 1985 survey of 29,000 key enterprises disclosed that 89 percent of people in leadership positions had higher education, and that the average age of managers had dropped significantly. [redacted]

Beginning in October 1983, China required that all managers of large and medium-sized enterprises take an examination on a number of economic, managerial, and party topics. To encourage participation, examination scores were linked to future promotions. According to Chinese press reports, more than 100,000 managers had taken the exams by the end of 1986, including almost 70 percent of managers from key enterprises. Leaders of smaller enterprises are also being tested. Despite these measures, one recent Chinese survey reported that 85 percent of industrial leaders believe the majority of factory managers are not qualified to carry out present reforms. [redacted] 25X1

Management Training Programs
The State Council has specifically noted the importance of advanced management techniques for quality control, internal factory financial accounting, establishment of technical standards, and streamlining factory organization (see inset on page 8). Management training programs have proliferated under both international and domestic sponsorship. [redacted] 25X1

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International Programs
Under a Sino-US science and technology protocol, the United States began management training classes for senior executives and industry directors at Dalian in 1980. The Dalian program, considered a complete success by both sides, has spawned such offshoots as a joint M.B.A. program between the Dalian institute and a US university. Many of the Dalian graduates—such as Wang Zhaoguo, now a Chinese Communist Party Central Committee member—have been appointed to senior party and government posts, and Chinese leaders have expressed their appreciation to the United States for being at the forefront in training Chinese managers in advanced management techniques. [redacted] 25X1

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China also has established joint management training centers with the EC (in Beijing), Canada (Chengdu), West Germany (Shanghai), and Japan (Tianjin). Beijing is discussing the establishment of another management training center with French and Australian participation, [redacted] and also has held discussions with Bulgaria and East Germany. 25X1

Experiments in Factory Management

[redacted] *Beijing is also experimenting—but on a much more limited basis than the factory manager responsibility system—with additional incentives, guidelines, and controls.* [redacted]

Management contract system. *Contract systems formalize and extend many of the elements of the factory manager responsibility system. These systems—also called term responsibility systems or tenure responsibility systems—require managers to sign three- to five-year contracts specifying targets for categories such as profits, quality and variety of goods, and managerial and technical innovation. If the contract is fulfilled, a manager's salary increases; failure to accomplish the goals may result in demotion, or, in cases of serious breaches of safety or production disruptions, dismissal. Managers appointed under the traditional industrial system submit yearly production plans, but no rewards or penalties are attached to achieving the goals. Some Chinese press reports imply contracts are a basic ingredient of management reforms, while others suggest contracts are used much less widely than the factory manager responsibility system. In Beijing, for example, 20 state-run factories began management by contract in April 1986, while the experience of 233 Shenyang enterprises with this system was so promising that the city government in 1986 decided to introduce the system to all enterprises.* [redacted]

Enterprise leasing. *As a means of increasing the manager's stake in an enterprise's success, small firms—usually heavily debt ridden—have been leased to individuals selected through a competitive process. The new enterprise director is required to have two financial guarantors and to commit a certain amount of personal property as collateral. The manager is given full power over the factory's personnel and operations, and agrees to pay a fixed level of profits to the state at the end of a predetermined period. Any extra profit may be kept by the manager, but shortcomings must be made up from the personal wealth of the manager and the guarantors. In 1986, according to the State Statistical Bureau, 2,900 small state-owned enterprises were experimenting with leasing.* [redacted]

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In the first enterprise to try leasing, according to Chinese publications, profits rose from 13,000 yuan in 1981 to 460,000 in 1985. The same person served as factory manager throughout the period, but, according to Chinese press reports, was able to make improvements in later years because leasing greatly increased his authority. The manager even fired 10 workers, and the party secretary with whom he frequently disagreed was transferred. [redacted]

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The asset management responsibility system. *This system applies selected aspects of enterprise leasing to large, state-run enterprises. A committee—usually consisting of government officials, factory officials, and outside experts chosen by the factory—advertises for a factory manager. Applicants for the post submit proposed plans for managing the factory, and a prediction of capital gains. The successful candidate is required to post collateral; one account reported a director put up his family property and one-third of his annual income; another manager provided a personal bond of 1,500 yuan (US $400), compared to a basic salary of 150 yuan a month. Through a series of contracts, the manager is given control of planning, management, and the employment, dismissal, and pay of workers. Standards for fixed-asset additions, capital turnover, and profits are agreed upon at the outset and are tied to a schedule of bonuses or fines.*

[redacted]

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An important addition to the manager's duties is the responsibility for obtaining capital funding, further severing the financial relationship between enterprise and state. The factory must obtain bank loans to meet its needs, and debt service payments are to be deducted from posttax profits. The state collects not only a corporate income tax but also a fee payable for the use of assets provided to the director. [redacted] *enterprises operating under this system will be taxed at a lower rate to encourage enterprises to make better use of their capital and to expand production. Trials of asset management began in the summer of 1986 in four enterprises, with at least 20 more planning to adopt the system, according to a Chinese press report.* [redacted]

Financial responsibility system. *The financial responsibility system goes beyond the asset management system by basing incentives for responsible management on ownership,* [redacted]*. The enterprise issues stock to workers, managers, and the general public, although the state maintains a controlling interest. An enterprise advisory board chooses a manager, helps in basic planning, reviews the enterprise's performance, and rewards or dismisses managers. Stockholders are represented on the advisory board, a device intended to neutralize political influences. Decisions not based on economic reasoning risk financial loss for both the enterprise and the individual. The Chinese official who* [redacted] *devised both the factory manager responsibility system and the financial responsibility system believes the latter is vastly superior, and that ownership is the key to improving factory performance. In September 1986 the State Council agreed to selected experiments with financial responsibility in a handful of cities.* [redacted]

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Foreigners are helping improve Chinese management skills through government-sponsored training centers, joint ventures, and on-the-job training. [redacted] 25X1
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Sweden and Great Britain are cooperating on a project to train Chinese in S&T management and planning. [redacted] 25X1
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China has further encouraged the transfer of management skills through joint ventures with foreign firms and through numerous seminars, some under government-to-government cooperative agreements, others sponsored by universities, businesses, international organizations, institutes, and societies. For example, Harvard University and the Chinese management association are cosponsoring a series on Beijing television to introduce Chinese viewers to US management techniques. Visiting experts discuss Western management experience through lectures, teaching assignments, and hands-on experience in Chinese factories. 25X1 China also is sending management trainees to Japan and the United States to receive private and corporate training in factories. [redacted] 25X1
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Matching Management Techniques to Factory Problems

China needs to use modern management methods in upgrading factory operations, particularly in such areas as:

- *Equipment justification. Because of the difficulty of obtaining equipment in the past, Chinese managers try to buy whatever equipment they can, rather than what they need; this is one reason Chinese enterprises generally ask for the most advanced technology.*

- *Inventory control. Enterprises hoard materials because of the uncertain supply; there is no concept of the cost of excess inventory.*

- *Quality control. China is increasingly familiar with quality control but lacks knowledge and personnel to institute statistical sampling and factory quality-control procedures.*

- *Accounting. Internal accounting procedures are needed, but firms are not used to gathering information, and data integrity is a problem.*

- *Financial decisionmaking. Use of economic grounds to evaluate proposed projects could improve choices, although application could be extremely difficult in China, where the cost of inputs such as material and capital is unknown.*

- *Shop floor control. Basic knowledge about how materials flow through the factory and how to efficiently organize steps in the production process is lacking in most Chinese enterprises.*

- *Marketing. Chinese firms lack basic information on suppliers, customers, and other producers. Methods for conducting market research are needed.*

Domestic Training Programs

A new domestic training program will train nearly 50,000 people by 1990; a trial program started in September 1986. According to Chinese press releases, only graduates of the program, run by institutes of higher education, will be entrusted with important posts and be eligible for promotion. 25X1 25X1

Other domestic training efforts include:

- Colleges of economic management, created by refocusing former party cadre schools; Chinese press reports claimed that by early 1987 a network of 93 such institutes existed.
- Management training programs run by the Chinese Association for Science and Technology, the Chinese Economic Management Association, and various ministries.
- Local educational efforts, such as an educational program in Shanghai—initially for younger workers—that attracted 24,000 technical and management personnel in 1985.
- Management study programs and research centers at colleges and universities, as well as postcollege adult education programs in management.
- Programs offered by the newly founded Women's Enterprise Association to promote an exchange of management knowledge and experiences among female managers.
- Publication of management materials, including a Chinese enterprise management encyclopedia by the State Economic Commission and the party propaganda department 25X1

Resistance to Reform

The impact of these reforms has been blunted by several factors. First, Beijing is struggling with several fundamental issues, and this is slowing implementation of the reforms. In the past, for example, the party made sure that industry served socialist goals, but now industry's attention is focused on making a profit and improving efficiency. The enterprise has 25X1 looked after workers' welfare by providing housing and other social services, but some reform leaders want to break off social welfare functions from factories. Similarly, the government is uncertain which responsibilities it should retain to sufficiently control the economy—for example, whether state ownership of enterprises must be loosened to stimulate productivity and, if so, how to justify such action in terms of socialist thought.

Second, management reforms now provide direct incentives for managers but little motivation for party secretaries and administrative organizations. On the contrary, policies often go directly against the interests of party and government officials, reducing their authority—the source of their prestige and perks—and holding out the possibility that their very jobs will be declared unnecessary. In comparison, the few benefits to these groups—more taxes from profitable firms and improvements in the quality, price, and supply of goods—are neither direct nor persuasive.

Debate Among the Leadership

Beijing has yet to demonstrate the resolve to sort out the key problem regarding the respective roles of the factory manager, the party official, the worker, and the state. A July 1986 State Council decision and regulations issued in October largely confused the situation, both by endorsing decisionmaking powers for managers—as embodied in the factory manager responsibility system—and by calling for directors to accept the supervision of workers, staff members, and other concerned parties.

The difficulties involved in resolving this issue have been magnified by recent events in China. The political turmoil surrounding the student protests and the resignation of Hu Yaobang as party general secretary in January 1987 has intensified the debate over economic themes and has put reformers on the defensive.[3] The discussion reflects disagreements over what role the party, government, and enterprise should play in China's changing economic system. This issue is at the heart of Beijing's management reforms, which are predicated on redefining the functions of party and government in daily enterprise affairs. Moreover, conservatives may be uncomfortable that management reforms have prompted the creation or expansion of services usually associated with market economies, such as advertising and legal services (see inset).

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As conservative officials have pushed themes such as more centralized control, management reforms in particular have been criticized. Conservative senior officials have stressed the importance of factory party leaders, sometimes building them up more than factory managers. At the same time, however, a number of key leaders and organizations have echoed Zhao's call for management reform in 1987, including Vice Premier Li Peng, one of the most conservative senior government leaders, suggesting that management reforms will continue as a policy initiative. 25X1

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Within the Factory

The Director Versus the Party Secretary. According to State Council guidance and public statements by Chinese officials, the party's responsibilities are now largely limited to overall enterprise policy (as defined by state directives and the state plan), general worker welfare, and political education programs. But, in general, party secretaries are not easily accepting this diminution of their authority. Chinese press accounts and US Embassy reporting indicate that, in factories experimenting with management reforms, managers generally can assert their decisionmaking authority over production but are encountering resistance from party secretaries regarding control over functions such as the appointment of midlevel cadres, changing employment levels, and the distribution of bonuses and housing. 25X1

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The Director and the Workers. Although the formal role of workers in factory affairs is generally limited to annual meetings of factory workers' congresses, managers have often found that they cannot threaten

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Changes in the Supporting Cast

A steel tube market in Shijiazhuang allows firms to buy and sell capital goods to meet their needs, rather than rely on state allocations.

As management reforms change the responsibilities and functions of managers and their factories, the supporting cast of characters is changing as well. Besides the enhanced role of the banking community, other new roles include:

- Marketing. *Market information is a key need for Chinese managers, and creative means for supplying it are appearing. According to a sample survey in 10 Chinese provinces and cities, 30 to 50 percent of enterprises have established data collection and analysis centers.*

- Advertising. *China has 70,000 advertising agencies doing a business volume of 700 million yuan a year, according to the Chinese press. Ads run in newspapers and magazines, and on radio and television. Some railways and urban communications departments have set up their own advertising agencies. Shanghai recently reported the first known instance of a Chinese suit for false advertising and faulty product design.*

- Suppliers. *The state's Material Supply Bureau formerly controlled the supply of over 250 kinds of materials—steel, cement, timber—to factories producing under mandatory plans, but now allocates only 23 materials. Firms often do not know where to buy materials and equipment. According to Chinese press reports, a number of groups have stepped in to fill the gap. Over 858 capital goods service companies help enterprises buy, sell, and transport goods not included in the state plan. At least one city has opened a capital goods market so that enterprises can trade their excess materials. Similarly, an association of machinery producers established a central office in Beijing to facilitate equipment sales.*

- Legal services. *A Chinese newspaper reports that nearly 40,000 Chinese enterprises have set up legal consultative offices. Such offices offer legal services to factory directors, take part in decisionmaking and management of a factory, and play a major role in technical and trade negotiations. Some factories report these offices have had an immediate impact; a Shanghai iron and steel works reported its legal office settled 79 default cases since 1983. The need for legal services will continue to grow as external relations become more complex.* 25X1

- The Press. *Managers frustrated by interference or criticism have turned for help to the press, which is now allowed to investigate and publicize wrongdoings in at least some locations. One Wuhan newspaper editor said his paper acts in part as a de facto investigatory agency for the provincial party committee, empowered to investigate, report, and expose problems. The Wuhan municipal government also decided to use the offices of city papers to collect information on marketing conditions, prices, and economic opportunities throughout China for dissemination to Wuhan enterprises.* 25X1

Beijing is playing an active part in setting up needed support systems by adopting technical standards, issuing regulations, establishing a nationwide quality-inspection network of over 100 test sites, and conducting quarterly inspections. 25X1 worker employment, or even pay workers different salaries, without encountering worker resistance. Such resistance can seriously impair a manager's attempts to improve productivity through promotions, bonuses, the hiring and firing of workers, and adjusting the size of the work force. Workers sometimes resent additional income earned by managers, and, in at least one case, resisted reforms intended to improve productivity because they saw the measures as an attempt by the factory director to increase his income at their expense. Several managers have told foreign observers they were reluctant to accept monetary incentives for fear of criticism by workers. To strengthen their positions, party secretaries sometimes curry favor with the workers, making managers reluctant to discipline workers for fear of uniting worker and party against them.

Dealing With Higher Authorities

Closely related to party obstructionism is bureaucratic meddling by local government officials reluctant to give up their role in enterprises, according to Chinese observers. The network of personal and political relationships between factory party leaders and the bureaucracy is extensive, with former factory personnel often staffing government and regulatory offices.

Local Financial Assessments. Despite State Council rules that local governments should not impose financial burdens on factories, many extract additional "cash contributions"—for funding local public projects, for example—or extort personal favors. One factory initially refused to donate an apartment for a local registration office, according to the Chinese press, but agreed after city officials refused to issue marriage licenses to the factory's workers.

Administrative Meddling. Another form of obstructionism comes from administrative "corporations." Local officials, unwilling to give up their role in production, set up the corporations—ostensibly to loosen their control over enterprises, but in effect creating another layer of control. One *People's Daily* article said most of the state's large and medium-sized enterprises are under the control of these administrative and semiadministrative companies; although the central government has relinquished some of its controls over industry, such companies have prevented the devolution of power from reaching the enterprises and continue to interfere in production decisions and operations. These corporations severely limit factory managers' decisionmaking authority over the hiring and firing of workers, supplies, production, and marketing. Moreover, according to the Chinese press, the organizations usually have no assets, but, by calling themselves corporations, they can intercept financial and material resources intended for factories. 25X1

Beijing has called for an end to such interference, and several jurisdictions have announced steps to limit these corporations. Industrial bureaus in Chongqing have been told to begin providing services instead of controlling enterprise activities. In August 1986, Shanghai announced it would disband 77 administrative companies within a year to give factory directors 25X1 more decisionmaking power in production. It is unclear how much autonomy such factories will have, though, since Shanghai's plans also call for some plants to form into associations for specialized production. 25X1

Prospects

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Thousands of factories—many widely publicized in the Chinese press—have increased product quality and profits through management changes, and these successes will encourage other enterprises to try new management techniques (see inset). 25X1

The management reform program faces a number of significant obstacles, however, that suggest reforms over the short term will bring improvements to industrial productivity and efficiency only at the margin. 25X1 We believe management reforms will continue as a policy initiative, but the ongoing debate over economic reforms will delay plans to better define the relationships between key players. For example, Beijing had said it would pass a state enterprise law to provide a framework for implementation of bankruptcy provisions and to define legal and working relationships between ministries, enterprises, and party officials, but in mid-March, the National People's

Signs of Progress

A number of trends have emerged that we believe indicate Beijing's management modernization program can, over time, address some longstanding weaknesses in Chinese enterprises:

- Professionalizing management. *Focusing attention on management as a separate function requiring special skills contributes to the establishment of a corps of people who think of themselves as managers—an important step in overcoming traditional ways of thinking about factory performance. Local officials also are recognizing the need for trained managers and are advertising for persons with advanced skills to head factories. Some foreign observers also suggest economic logic is slowly supplanting administrative reasoning as a basis for decisionmaking.*

- New influences on production decisions. *Managers responsible for their firms' profits are increasingly concerned with productivity and quality control. Beijing's expanding network of quality-inspection sites further encourages factory directors to take quality control seriously; Beijing uses the quality-control ratings to determine the distribution of some resources, whether enterprises can use "quality" award labels on their products to attract consumers, and managers' remuneration.* [redacted] *firms rejecting substandard or overpriced components and finished goods reflect the additional pressure on factories to raise quality and improve efficiency. State-sponsored experiments with secondhand equipment markets are encouraging factories to sell unused equipment and to consider alternatives to expensive technology imports.* [redacted] *factories are beginning to use feedback from consumers to guide production.* 25X1

- Stimulating innovation and technology absorption. *The Chinese press has noted several new product designs by enterprises undergoing reform.* [redacted] 25X1 25X1 25X1 *better management is slowly improving technology absorption.* [redacted] 25X1 [redacted] *managers are becoming more interested in doing feasibility studies to assess the need for new technology, while preliminary training and preparation have greatly improved the use of equipment in some cases. One small survey of Chinese factories noted that technology import offices were being established within enterprises to evaluate proposed acquisitions, establish links to suppliers of related equipment, and assist in technology utilization.* [redacted] 25X1

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Congress (NPC) Standing Committee decided not to recommend its passage. The Chinese press reported that, although most delegates agreed that factory managers must have the final say over production decisions, they disagreed on the appropriate role and authority of party secretaries. Similarly, efforts to use a new Ministry of Supervision—agreed upon at the November 1986 NPC session—to oversee government policy implementation also will proceed more slowly. According to US Embassy reporting, this ministry was intended to shield factory managers from government interference. [redacted]

Meanwhile, the debate will probably cause party officials to be even more recalcitrant about following reforms, and managers to be more hesitant about implementing them. Since January, factory party leaders have been delegated to run in-factory propaganda campaigns to oppose "bourgeois liberalism"—China's catchword for excessive Western influences; at least some factory directors undoubtedly will seize the opportunity to go beyond educational activities to more direct involvement in the work of managers. [redacted] most factories in Beijing and Shanghai are again holding political party meetings that both workers and managers must attend. Party functionaries also are reportedly being added to the staffs in those cities. [redacted]

Many of the macroeconomic reforms that are essential to factory modernization and management reform will probably be slowed or postponed. For example, the reformers have already suspended their plans to move forward in controversial areas such as price reform, which will limit the ability of factory managers to improve enterprise performance (see appendix). [redacted]

In addition to political obstacles, the sheer enormity of the task dictates that improving management in China's nearly one-half million industrial enterprises will take a great deal of time. Training is reaching only a fraction of China's managers. The US program, for example, has taught both short and longer term courses to only about a thousand Chinese policymakers and industrial managers in five years; the Sino-Japanese management center is intended for 150 students a year. Domestic programs are more numerous but start small as well. Provincial economic management institutes, according to a 1987 press report, were designed to train 100,000 managers annually—a figure we believe to be greatly inflated. Experienced teachers of management also are in short supply. In addition, China must train personnel such as auditors and statisticians to help implement modern management within the factory. [redacted]

[redacted] regardless of training, most Chinese managers are slow to grasp the need to be results oriented, and are reluctant to make independent decisions and assume responsibility for their actions. [redacted]

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Appendix

Macroeconomic Reforms and Their Impact on Management

A number of macroeconomic reforms are essential to the success of management modernization.

Bankruptcy Legislation. The Standing Committee of the National People's Congress advanced the effort to make enterprises responsible for their performance and reduce state subsidies in November 1986 by passing China's first bankruptcy law. According to US Embassy reporting, the bill's adoption was delayed until its opponents were assured that it contained: guarantees that workers would receive unemployment benefits and, eventually, new jobs; administrative penalties for managers and bureaucrats whose management decisions result in enterprise indebtedness; and provisions for complementary laws and reforms that place real authority for enterprise management decisions in the hands of the managers. Formal implementation of the bankruptcy law—originally scheduled to occur in June 1987, three months after passage of the related state enterprise law—apparently has been delayed by the March 1987 decision of the National People's Congress Standing Committee to postpone a decision on the enterprise law, although experiments in applying the bankruptcy law are under way. The new law is limited in application and retains a significant role for the state—assets of closed enterprises will remain state property, and the government will play a major role in relocating workers—but it will probably help Beijing to compel factories to improve operations and accept further reforms.

Price Reform. State control of prices for raw materials and finished goods continues to hamstring managers. For example, companies that relied solely on the state for the provision of materials—especially scarce ones—now must often pay higher prices because subsidies inherent in the state-supply system are ending; but the firms have little or no power to pass higher production costs on to the consumer. Limits on the ability to adjust product prices also reduce the incentive for managers to improve the product because a better product earns no additional income. Beijing has lifted price controls for some consumer goods, overplan production, and out-of-plan production. It had planned to continue price reform for selected goods in 1987 but now has postponed such measures. 25X1

Human Resources. Lack of job mobility and the limited supply of skilled workers prevent enterprises from acquiring needed managerial and technical skills. Even if a factory director recognizes an opportunity to change operations, products, or quality, finding the personnel qualified to implement the changes remains a stumblingblock. For example, a Chinese factory wishing to upgrade its product by adding electronics would often be unable to hire the engineers needed. Beijing has issued regulations in recent years giving skilled personnel the freedom to go where their talents are needed, and some moves have occurred. barriers 25X1
to personnel mobility, such as factory ownership of housing, remain strong. 25X1

Labor Reform. A manager trying to improve labor productivity and efficiency is hampered by restrictions on the hiring and firing of workers, and on adjusting the size and composition of the work force. Beijing took an important first step toward reforming labor practices in October 1986, when it adopted a labor reform package eliminating guaranteed lifetime employment for new workers in state factories and giving managers additional authority to fire employees. 25X1
The reforms also create national retirement and unemployment systems. According to press reports, Beijing will allow enterprises to hire an increased share of workers under fixed-term contracts—making it easier for factory managers to adjust the size of the work force according to production needs. Enterprises also are experimenting with additional measures linking salaries and incentives to worker productivity. Implementation of labor reforms, however, will be slow. 25X1

Financial Reform. A decrease in state allocations of working and investment capital is forcing enterprise leaders to search elsewhere for funds. As a result of changes in China's banking system, bank loans have become an increasingly important source of financing.[4] Beijing also is allowing experiments with issuance of shares and bonds. In Guangdong, approximately 850 enterprises had raised more than 500 million yuan through securities by the end of 1985. In addition, 25 banks in the Shanghai Economic Zone set up a short-term capital market and a long-term securities market. Controls on foreign exchange remain a problem for many managers, however. Factory directors in Sichuan told visiting US officials that access to foreign exchange to import technologically advanced equipment is their most urgent need.

Bureaucratic Reforms. Although the state has given up some of its direct involvement in industry, managers remain constrained by the continued need to seek approval from higher authorities for a variety of decisions, from technology purchases—especially imports—to construction projects:

- A June 1986 survey of almost 1,600 senior executives in Beijing and Tianjin showed that only 103 had the authority to install a personal computer or a microcomputer; only 50 could approve the purchase of other office products, such as copiers.

- In 1981 a Hunan factory applied for permits to begin construction of a beverage bottling plant and to import automated equipment. During the next five years, the proposal was revised three times, reviewed by 60 separate government offices, which affixed more than 200 signatures to 200 documents, but the proposal was not disapproved or approved.

An important goal of the "political structural reforms" originally slated to occur during the next several years is streamlining China's bloated and overlapping bureaucracy, but the reforms also have been postponed as a result of the ongoing debate over political and economic issues.

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