National Foreign Assessment Center

China: The Continuing Search for a Modernization Strategy

A Research Paper

Approved For Release 2001/12/05 : CIA-RDP86B00985R000300050011-3

ER 80-10248
April 1980

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Research for this report was completed on 15 February 1980.

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China: The Continuing Search for a Modernization Strategy

Summary

For the past two years the fundamental problem for policymakers of the People's Republic of China has been deciding upon the means for transforming the world's largest underdeveloped country into a modern, industrialized state. Freed of the dominating influence of Mao Zedong in 1976, the PRC leadership's first attempt at solutions was embodied in the 10-year draft plan (1976-85), unveiled in February 1978. The plan was intended to lay the groundwork for eventually bringing about the "four modernizations"—of agriculture, industry, national defense, and science and technology.

Although the new plan gave more prominence to developing agriculture than in the past, the plan's central focus on heavy industrial growth constituted a continuation of Chinese policies of the previous two decades. The most innovative element in the plan was China's unprecedented willingness to use massive imports of Western equipment and technology in the development effort.

Between the announcement of the new plan in February and the watershed Third Plenum of the Chinese Communist Party in December 1978, the CCP leadership came to a new and sobering appraisal of the size and nature of the gap between China's existing capabilities and its ambitions. During 1978, surveys of PRC natural resources, construction programs, and trained manpower—together with investigations of how Chinese production processes and institutions had functioned over the past decade—began to give the leadership a much better appreciation of China's weaknesses. On the international side, the knowledge garnered from the surge in delegations sent abroad and from foreign visitors to China made the government more aware of the costs and problems involved in exploiting foreign resources.

By the time of the Plenum the central leadership had also concluded that large segments of the Chinese Communist Party were not oriented toward the goals of modernization and could not be depended upon to be fully responsive to orders from the central authority. At the same time, the regime also concluded that other important institutional changes were necessary—in legal systems, in educational and cultural policy, and in attitudes toward population control—for economic modernization to proceed.

At and after the Third Plenum the leadership shelved the 10-year plan and embarked on a three-year (1979-81) readjustment program. The underlying theme of Chinese domestic policy since then has been that economic productivity, consumer welfare, and political stability are interrelated. The

many changes in economic policy since the Plenum—increasing the material incentives for production and hence the incomes of workers and peasants, installing new systems of rewards and penalties for individual managers and economic entities, and experimenting with new and more efficient forms of industrial organization—are all aimed at productivity increases.

In effect, the regime is making an unprecedented appeal to the self-interest of the Chinese population. Incomes are beginning to rise, most notably in agriculture, but also in industry, and the leadership has already begun to grapple with the problem of managing and meeting consumer demand for more and better quality goods and services. The growth of consumer expectations is now a major problem for the government and will remain so for years to come.

Political stability enters into the relationship between consumer welfare and productivity because the leadership believes that its grasp on power and the permanence of its policies pivots on demonstrating the benefits of the new policies for most of the Chinese population. In the absence of improvements in consumer welfare, productivity will remain low and the potential for political disruption, as well as the leadership's vulnerability to challenges from within the party, will increase.

Resource allocation policies were also shifted at and after the Third Plenum by the leadership to support the new policy course. Investment in heavy industry, particularly iron and steel, was cut back while the allocations to agriculture, light industry, and the building materials industry were increased. While maintaining its interest in acquiring foreign equipment and technology and continuing to solicit and to receive long-term credits to pay for it, the leadership suspended or postponed a number of planned purchases from abroad. The domestic construction program was also cut back, eliminating poorly planned projects and those requiring long lead-times. The new priorities focus on easing longstanding constraints on industrial production—electric power, coal and building materials, and transportation.

The leadership will not be able to complete this "readjustment" within the planned three-year period and has already indicated that the process will take more time. First, the new policy course still has not been completely accepted within the party, in part because the changes are such radical departures from the policies of the Maoist era and in part because of bureaucratic resistance to changes of any kind. Since May 1979 a campaign has been under way to defend the policies of the Third Plenum and to screen out party members unwilling to adapt to the new tasks of modernization. Second, although the new incentives policies have given new impetus to

production in agriculture, the changes in industrial incentives and organizational policies are being implemented only slowly and have not so far stimulated industrial output. Third, new construction in the bottleneck areas of Chinese industry will take three to five years to complete; hence the present constraints in the energy, raw material, and transportation sectors probably will not begin to loosen until some time beyond 1981.

Over the next few years, we expect the growth of gross national product to fall off from the average 6-percent rate of the past two decades to around 5 percent. Moreover, the sources of growth will also change, with industrial growth slowing, perhaps to around 6 to 7 percent per year, and agricultural growth picking up significantly to something on the order of 4 to 5 percent per year. While foreign equipment and technology will continue to flow into the PRC at higher rates than in the past, deepseated problems in absorbing these imports will be overcome only gradually. With the exception of imported fertilizer plants, foreign technology is unlikely to have much of an impact on production during this period.

The experiences of the past two years have made the Chinese leadership circumspect in discussing possible development strategies for the 1980s and 1990s. It cannot make systematic, long-term plans for the economy until the results of the current period of readjustment begin to come in. The sparse information received thus far on Chinese thinking about the next two decades suggests, however, that agricultural development will continue to be viewed as the fundamental basis for economic modernization and the point of departure for pursuit of import substitution policies. These policies would gradually decrease the present PRC dependence on imports for food, fibers, and industrial materials and eventually lead to greater use of export earnings for purchases of high technology processes and equipment. This strategy seems aimed at initially heavy exploitation and then eventual diminution of PRC economic linkages to the developed world to create the conditions for domestically driven, "self-reliant" economic growth.

In any case, two major variables affect economic as well as all other plans for long-term modernization: The first is whether the present leadership can consolidate its hold on power and implement its current and contemplated economic policies. Success in this endeavor is by no means assured and is further complicated by the likelihood that many in the leadership will pass from the scene during the next five to 10 years. The second is whether the policy of placing a low priority on Chinese military modernization by linking it to the eventual development of a modern industrial base can be continued. A serious deterioration in relations with the Soviet Union or Vietnam could lead to increased allocations of resources to the military at the expense of economic development.

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The Challenge of Modernization

Historical factors and others of more recent origin are driving the Chinese leadership in its effort to modernize the PRC. The present leadership's perception of the weakness of China relative to the great powers, the USSR, Japan, and the United States, was also shared by their predecessors, going back to the last century. Similarly, China's present leaders share their predecessors' fundamental conviction that China rightfully belongs in the front rank of the world powers. The Chinese Communist achievement has been the unification of the state and the mobilization of its potentially rich human and material resources to a point where the PRC is now accepted as a major participant in the international arena and is now less vulnerable to pressures from outside powers than it has been since the mid-1800s.

Nevertheless, China remains a huge underdeveloped country with an economy that has grown at a respectable rate of about 6 percent (about the same as the average growth rate of all non-Communist less developed countries since 1961). With a population of 1 billion per capita GNP works out to around $400 per year (see the table). In recent years the Chinese leaders, like leaders in a number of other LDCs, have grappled with slow rates of increase in agricultural production that only narrowly exceed the 2-percent annual rate of growth of population and has periodically been forced to import grain from abroad for maintenance of consumption levels. As with other LDCs, China's industry provides only limited opportunities for expanded employment and embodies levels of technology that with few exceptions range from 10 to 30 years behind those of industry in the developed countries. Inadequately developed systems of transportation, distribution, and fuel and power supply also cause sporadic fluctuations in industrial output.[1]

Several factors separate the PRC from the rest of the less developed world. First, China has a modest but credible nuclear force and maintains a 4 million man

[1] Detailed appraisals of these and other aspects of the economic situation in the PRC are contained in "The Chinese Economy Post-Mao," Joint Economic Committee of the US Congress, November 1978.

Table

China: Economic Indicators

	1952	1957	1965	1970	1975	1976	1977	1978	1979
GNP (billion 1978 US $)	99	138	185	263	368	368	398	444	468
Population (million persons, 1 July)	570	640	753	848	952	971	987	1,002	1,018
Per capita GNP (1978 US $)	174	216	246	310	387	379	403	439	460
Agricultural production index (1957=100)	84	100	101	126	148	148	144	156	160
Total grain (million metric tons)	161	191	194	243	284	285	283	305	315
Cotton (million metric tons)	1.3	1.6	1.6	2.0	2.4	2.3	2.0	2.2	2.2
Industrial production index (1957=100)	48	100	199	316	502	502	574	651	703
Crude steel (million metric tons)	1.3	5.4	12.2	17.8	24.0	20.5	23.7	31.8	34.0
Crude oil (million b/d)	0.01	0.03	0.23	0.60	1.54	1.74	1.87	2.08	2.12
Coal (million metric tons)	66.5	130.7	232.2	327.4	478	483	550	618	625
Foreign trade									
Exports, f.o.b. (billion current US $)	0.9	1.6	2.0	2.2	7.1	7.3	8.1	9.9	13.0
Imports, c.i.f. (billion current US $)	1.0	1.4	1.8	2.2	7.4	6.0	7.1	11.2	14.7

conventional armed force that dwarfs those of other LDCs. While China's capabilities for defending its territory against conventional attack seem strong, like other LDCs it has only limited capabilities for using its forces far beyond its borders. Second, although it shares many of the problems faced by other predominantly agricultural LDCs, China has a better cushion against wide swings in total crop output (as India, for example, does not), since it grows a large number of diverse crops under a variety of differing weather regimens. Yields per hectare for most Chinese crops, while higher than those in many LDCs, also have some distance to go before diminishing returns set in. Third, China's energy and mineral resource endowment compares favorably with those of the United States and the USSR; but except for oil the PRC's exploitation of these resources has been slow and difficult. Fourth, since breaking its close relationship with the Soviet Union in 1960, China has only recently begun to develop the linkages with the world economy that prevail in most LDCs. This has clearly lessened its vulnerability to foreign economic pressures, kept levels of foreign debt low, and insulated China from the effects of adverse developments in the world economy. Nevertheless, it has also severely limited the PRC's access to the financial and technological resources of the developed world.

The PRC appears also to have distributed the sparse fruits of economic growth more evenly among its huge population than is the case in almost every other LDC. This has been accomplished through rationing and other administrative policies and by promoting a national ethos that deemphasizes material rewards as incentives to production. Although this more equitable pattern of income distribution contrasts strongly with conditions in other LDCs, that accomplishment has entailed a substantial if unquantifiable cost. The more rapid growth and industrial development that marks such LDCs as South Korea and Taiwan is in part the result of government policies of emphasizing material incentives to production despite the consequent widening of income differentials. Finally, for the past two decades the PRC has experienced political upheavals that have brought economic progress to a halt, crippled the institutions of government—including the ruling Chinese Communist Party—and led sizable segments of lower level party and government cadre to avoid responsibility and initiative in their work for fear of political reprisal.

Thus the problem of China's economic, military, and political backwardness has been only partially ameliorated over the past three decades. The current leadership is nominally headed by Hua Guofeng but has been goaded into seeking new ways of grappling with the problem by Deng Xiaoping. The leaders appear convinced that this backwardness must be rectified if the PRC is to project more forcefully the preeminent role in Asian and world affairs that they perceive to be its right. This perception of weakness has been reinforced by their observation of the rapid rate and increasing complexity of technological change and its impact on both defense establishments and conditions of life in most countries of the world. Further, many of the leaders now appear to have concluded that the political institutions and modes of governing that have evolved in the PRC since the late 1950s have constrained growth and are at least partially responsible for the widening of the gap between Chinese economic and technological levels and those of the developed world. The system of government in China from 1949 to 1976 was deeply influenced by the visionary and sometimes capricious decisions of one man, Mao Zedong. Both outside observers and, latterly, many of the current leadership cite Mao's dominance of policy as the major factor responsible for the political instability and the poor performance of the economy after the Leap Forward of 1958, and during the Cultural Revolution of 1966-71 and the succession struggles of 1974-76.

The attempt to change the PRC's status from that of an LDC to a front-rank developed state is described as the program of achieving the "four modernizations"—of Chinese agriculture, industry, national defense, and science and technology—by the end of this century. To accomplish this, however, it will also be necessary to achieve what might be called a "fifth modernization." That is, installing a new political and social order that will facilitate rather than constrain the leadership's attempt to overcome the many obstacles that lie ahead.

The Modernization Effort

All Chinese discussion of the "four modernizations" since the idea was first broached by Zhou Enlai in 1975 have viewed the process as a multistaged effort to achieve the status of a "front rank" economic power by the year 2000. To date this general goal has not been more precisely defined and the leadership has been circumspect about announcing specific goals for what they call the "New Long March." Announced long-term goals have been few in number and subsequently revised downward or abandoned. Ongoing discussion of planning priorities and the clearly evolutionary nature of current policies suggest that the process of determining the ends and means of China's modernization will remain a practical matter involving much trial and error.

The Transient 10-Year Plan. Most of the known long-term economic goals were made public when the draft outline of the 10-year plan (1976-85) was discussed by Chairman Hua Guofeng at the Fifth National People's Congress in February 1978. Grain production was targeted to reach 400 million tons by 1985, implying an expected annual rate of growth of 4.3 percent—well above the 3.2-percent average of 1965-77. The value of total agricultural output was projected to rise at an annual rate of 4 to 5 percent, or 1 to 2 percent above the rate prevailing between 1965 and 1977. Industrial production was planned to rise at more than 10 percent annually, also above the 9 percent average annual growth of the past decade. Steel production was slated to nearly double from the 32 million tons produced in 1978 to 60 million tons in 1985. Two goals revealed in other discussions during 1978 were that coal production by 1987 (rather than 1985) would double to more than 1 billion tons and that light industrial production between 1978 and 1985 would grow at a 12-percent annual rate—sizably faster than the 7 to 8 percent rate of growth of consumer goods over the previous two decades.

To attain these ambitious levels of production, Hua Guofeng noted that agricultural investment would be stepped up and that "basic" mechanization of agriculture would be achieved by 1980 in order to break the sector out of its past pattern of slow growth and to provide impetus for overall economic development. In addition, Hua sketched out an investment program for industry and transportation asserting that during the next eight years "the state plans to build or complete 120 large-scale projects, including 10 iron and steel complexes, nine nonferrous metals complexes, eight coal mines, 10 oil and gas fields, 30 power stations, six new trunk railways, and five key harbors." The magnitude of the proposed effort to invest in new capacity was underlined by Hua's statement that the capital construction effort as a whole in 1978-85, in terms of funds budgeted, would equal the total for the previous 28 years.[2]

The Great Leap Outward. The key element that set this program of economic modernization apart from such earlier Chinese pushes for economic growth as the First Five-Year Plan (1953-57) and the Great Leap Forward of 1958 was the major role assigned to massive imports of Western equipment, complete plants, and technology. Although official pronouncements in favor of expanding foreign trade and making greater use of foreign technology to speed modernization began soon after the fall of the Gang of Four in 1976, during 1978 not only foreign trade and commercial policies but the whole spectrum of PRC attitudes toward the outside world shifted into more open and liberal lines.

In February 1978 an eight-year long-term trade agreement was signed with Japan calling for an exchange of $10 billion worth of Chinese oil and coal for an equal amount of Japanese plant and equipment. Later in the year Beijing and Tokyo agreed to extend the agreement for an additional five years. At midyear a trade agreement was signed with the European Community setting up a framework for expanded trade and by yearend several technical cooperation agreements had been signed with foreign countries and organizations. PRC investigation of the systems of industrial and business management used in the non-Communist developed states as well as in Romania, Hungary, and Yugoslavia intensified. Beijing also began sending the first of what were expected to be large numbers of Chinese students abroad to study

[2] An overall appraisal of the program is contained in CIA ER 78-10680, *China: In Pursuit of Economic Modernization*, December 1978, Unclassified. Detailed analysis of PRC prospects in coal and iron and steel are contained in CIA ER 79-10092, *Chinese Coal Industry: Prospects Over the Next Decade*, February 1979, Unclassified, and CIA ER 79-10245, *China: The Iron and Steel Industry in the 1970s and 1980s*, May 1979, Unclassified.

science and technology and opened China up to foreign scholars, students, and tourists as well as foreign technicians and businessmen. Domestically, the PRC reinstated the study of foreign languages, primarily English and Japanese, both in the slowly reviving formal education system and in part-time programs in factories and in urban areas.

Most attention focused, however, on the PRC import program. During 1978 the number of Chinese delegations going abroad and foreign businessmen coming in surged as Beijing stepped up its search for industrial technology and equipment from Japan, Western Europe, and the United States. By the end of the year the PRC had been involved in negotiations for about $40 billion in complete industrial plants, modern equipment, and related technology, and had signed contracts amounting to $7 billion.

In mid-1978 still more projects were added to the PRC construction program. These indications that the timetable for modernization had been accelerated plus the high level of PRC negotiating and fact-finding activity abroad fueled speculation that the import program was carefully worked out and would involve hundreds of billions of dollars in capital equipment and technical services. On the other hand, Li Xiannian was reported in the fall of 1978 as observing that a two-year period would be necessary before PRC economic construction programs could get off the ground. At the same time, a number of foreign visitors noted that the Chinese were unwilling to discuss the specifics of the import program.

Uncertainty and an openness to change also marked other aspects of PRC foreign trade and financing policies throughout 1978. By midyear the regime had announced that it would accept such unprecedented arrangements: (a) long-term credits and the financing of capital imports through foreign bank deposits with the Bank of China; (b) barter and compensation deals for plant purchases; (c) the importing of materials to reprocess for export; (d) designation of certain factories to produce goods for specific foreign markets; and (e) fuller compliance with international standards on patents, trademarks, and copyrights. At the same time Chinese officials had also maintained that direct government-to-government loans, joint ventures with foreign firms, and private foreign investment were unacceptable. By yearend, however, the PRC had dropped these strictures and all three measures were under consideration.

In summary, the only new element in the draft 10-Year Plan was the unprecedented readiness of the PRC to develop closer linkages with the developed world. While agricultural development received more prominence than in the past, the plan retained the PRC's traditional emphasis upon rapid heavy industrial development. In focusing popular attention on this new and optimistic plan for the future, the leadership also appeared to be attempting to get the population "on board" and looking forward—rather than dwelling on the economic problems and political disruptions that had occurred since 1967. In any event, it is clear that the obstacles to carrying out the plan posed by China's economic problems were not completely understood by the leadership until after the plan was announced.

Between the February 1978 announcement of the 10-Year Plan and the watershed Third Plenum of the CCP in December 1978 the Chinese leadership came to a new and sobering appraisal of the size and nature of the gap between China's existent capabilities and its ambitions. During 1978, surveys of the PRC's natural resources, construction programs, and trained manpower as well as investigations of how Chinese production processes and institutions had functioned over the past decade had begun to give the leadership a much better appreciation of China's weaknesses than was the case earlier in the year. On the foreign side, the knowledge garnered by delegations sent abroad and from foreigners visiting the country made the government more cognizant of the costs and problems involved in exploiting foreign resources.

Economic performance during 1978 was also not reassuring to the leadership in its attempt to modernize. On one hand, the leadership could derive satisfaction from the recovery of agricultural production in 1978—up 8 percent after three years of no increases. On the other hand, Chinese industrial production, which had begun to level off during the last three quarters of the year, was disappointing and appears to have been a major factor behind the new industrial policies brought forward in December. By the time of

the Plenum the central leadership had also concluded that the Chinese Communist Party apparatus itself was deeply resistant to the kind of changes required for modernization. Policies adopted at and after the Third Plenum strongly suggested that some of the higher level party leaders and much of the CCP rank and file were insufficiently responsive to directives from the center and remained unwilling to depart from the policies and practices of the past.

All of these problems were examined in depth at several lengthy conferences on economic and political problems held between mid-September and 15 December when the Plenum was formally convened.

The CCP Change in Course—the Third Plenum, December 1978. At the Third Plenum the CCP formally announced that the emphasis on political struggle of past decades had ended and that the general tasks of the party now would focus on "socialist modernization." The new focus, however, was not on pushing for ambitious, long-term goals but rather on remedying the conditions that constrained rapid economic development. Thus the draft 10-Year Plan, announced 10 months earlier, was not mentioned in the materials of the Plenum. Rather the Plenum focused on the national economic plans (*ji-hua*) for 1979 and 1980. These annual plans were described as parts of three-year (1978-80) and eight-year (1978-85) programs (*gui-hua*) for the "development of the national economy" as well as part of a 23-year (1978-2000) outline (*she-xiang*) for the Four Modernizations. The semantic distinctions between plans, programs, and outlines reflected the varying degree of firmness with which the leadership had come to view its prospects and goals over time.

With the shelving of the 10-Year Plan at the December Plenum, the PRC leadership became much more concerned with the solution of short-term problems and the establishment of a firm foundation for modernization than with the attainment of long-term production goals. Thus the three-year period 1979-81 was to be a time of readjustment and preparation. In January 1979 Japanese newspapermen asked Hu Qiaomu, a senior theoretician and close associate of Deng Xiaoping, if concrete plans for modernization had been worked out. Hu replied that they had "no particular blueprint . . . the goal we have set is to move forward step by step and continually gain experience."

December 1978 constitutes a watershed in PRC history because of the large number of new policies and changes in old policies initiated at the Third Plenum. Changes in planning priorities were one of the more important results of the Plenum. The conferences of fall 1978, held to draw up economic planning proposals for consideration by the Plenum, apparently had recommended a shift of resources away from heavy industry and toward light industry and agriculture as well as a cut in the number of industrial capital construction projects. The Plenum accepted the proposal on raising the priority of agriculture and light industry; the proposed cutback in industrial projects apparently was not acted upon until two months later. On 24 February an authoritative *People's Daily* editorial suggested that investment in the steel industry should be reduced in the interest of more balanced development of other sectors, notably agriculture and light industry. This was followed in early March by Li Xiannian's admission that he and others in the leadership might have been "overhasty" and that some of the targets for 1985, steel in particular, were too high and ought to be scaled back.

By the end of March, the proceedings of national capital construction and chemical industry conferences revealed that construction plans were to be "adjusted" through halting and postponing industrial projects. On 24 March *People's Daily*, paraphrasing Lenin that "we go one step backward to go two steps forward later," admitted that construction plans had been too ambitious and that the process of deciding upon which projects would be stopped or postponed was under way. The decisions arrived at are still not entirely known and their impact has yet to be fully felt, mainly because both a number of central government ministries and provincial authorities continue to circumvent the cutback policies. In general, it appears that the steel, machine building, and chemical industries were to be most affected and that projects in the coal, electric power, petroleum, transportation, and building materials sectors were to be less affected. Agriculture and light industry and those projects which could be brought into production within a short time were to be developed rapidly. Housing, public utilities, scientific

research, education, and health were also slated to receive additional attention. Beijing's explanation of the need for the cutback focused on such factors as insufficient supplies of power, construction materials, and skilled manpower and the initiation of construction projects without paying sufficient attention either to where raw materials for the new plants would come from or to how their output would be used. *People's Daily* summed up the influence of these factors by noting that since the early 1960s the value of completed capacity additions as a proportion of investment outlays had steadily fallen.

The mid-February suspension of over $2 billion in contracts with Japan, coming at a time when the PRC was cutting back on construction plans, raised the possibility that the leadership was pulling back from China's new policy of developing increased linkages with the developed states. However, contracts with non-Japanese suppliers were not affected and the suspension was mainly attributable to such factors as PRC miscalculation of payment requirements, a consequent temporary shortage of foreign exchange, and Japanese reluctance to provide more favorable credit terms. The PRC subsequently lifted the suspension in May 1979; the net effect apparently was to further delay the timetable for the huge Baoshan iron and steel complex.

The shift in policy course at the Third Plenum and the subsequent flux that has marked Chinese modernization policies primarily reflected the leadership's realistic appraisal of the dimensions of China's economic problems. Nevertheless, Deng and the leaders associated with him also appear persuaded that the permanence of both their hold on political power and their policies for modernization had become contingent upon accomplishing two tasks. The first was neutralizing those within the CCP who would slow the pace of change and, second, rapidly demonstrating that their programs were in the best interest of most of the Chinese population. Thus, the present thrust of PRC policy for the short term, that is, the next two or three years, is fairly clear; that for the years beyond is much less so.

Short-term Policy

The fundamental premise of PRC economic policy since the Third CCP Plenum of December 1978 has been that consumer welfare, economic productivity, and political stability are indivisible. The premise was elaborated in detail at the Fifth National Peoples Congress (June 1979) and the leadership's strong commitment to it was evident during the Fourth Plenum of the CCP (September 1979) as well as in Vice Chairman Ye Jianying's 1 October speech commemorating the 30th anniversary of the founding of the PRC. Throughout this period additional emphasis has been given to raising personal income and consumption in rural and urban areas from the stationary per capita levels of the past decade and to providing the goods necessary to meet the new demand that will be generated by increased incomes. Thus production in the agricultural and light industrial sectors has been further stimulated both to provide increased goods for domestic consumption and for exports. (Agriculture and light industry account for almost two-thirds of PRC export earnings.) Since December the already high priority of agriculture in investment allocations has been further raised. New investment including imports of foreign technology, has also been planned for light industry which until December 1978 has been expected to expand production with little new investment. Striking changes in PRC policies concerning the incentives to produce, the systems of managing production and political activity in the economy have also occurred.

In agriculture, for example, prices now paid by the state for farm produce have been raised and the quantities procured by the state on compulsory terms are to remain constant for five years. Prices paid by the peasant for such industrial inputs as fertilizer, pesticides, and farm machinery are also being lowered. Taxes on the income from rural industrial and commercial undertakings have been cut while the tax exempt periods for newly established rural enterprises have been lengthened. Production teams in low-yielding and grain deficient areas are to be exempted from agricultural taxes altogether. The primacy of production teams as the locus of economic decision-making has been strongly reaffirmed to give them wider latitude for planting the crops they grow best and thus enhancing their opportunities for increased incomes. Evidence so far received indicates that this last measure has led many teams to shift their cropping patterns away from grain crops and into cash crops—

vegetables, tobacco, oilseeds, and the like. The government is supporting the trend toward establishing more rational cropping patterns by repudiating past policies of "onesidely" emphasizing grain production and by surveying agricultural growing areas in each province and designating specific zones for specialized crop production.

Some of these measures will cut into state revenues and others will make food a more expensive commodity in the cities. The leadership is willing to accept the decline in state revenues that may result from raising farm procurement prices and lowering the prices of industrial goods sold to farmers even though it may make the provision of funds for investment more difficult. The Third Plenum had also noted, for the first time, that subsidies to offset increased urban food prices would be necessary. While state retail grain prices have not so far been raised, Beijing began giving subsidies to individual urban consumers to partially cover the cost of the November 1979 rise in state retail prices for meat, eggs, milk, and other "nonstaple" foods.

Measures have also been taken to ensure that neither a poor harvest nor a decline in the flow of grain into the cities, as a result, for example, of the changes in crop patterns noted above, will seriously affect urban grain supplies in the near term. Thus over the past year China signed three-year (1979-81) grain agreements with Australia, Argentina, and Canada that will allow the PRC to import 6 million to 7 million tons of wheat and corn during each year of the agreements. Further, the PRC has said that it expects to import 5 million to 6 million tons of grain annually from the United States over the next five years.

Incentive policies in industry, transportation, and the services sector are evolving more slowly but nevertheless in similar directions. A small wage increase was granted to about three-fifths of the urban labor force in 1977, and on 1 November 1979 the government announced that further wage increases would be distributed to 40 percent of the urban work force on the basis of promotion for merit. Although an across-the-board wage increase and establishment of a system for regular promotions have periodically been discussed, the government has not so far implemented such measures. Rather, the leadership appears to be experimenting with measures whereby remuneration is more closely tied to productivity; that is, piece rate wages, selective promotions on merit, and systems of rewards and bonuses for individuals and enterprises that meet and exceed production quotas.

Since December the regime has experimented with a system under which enterprises that fulfill production quotas and contracts are allowed to keep an additional small percentage of profits normally turned into the state. These retained funds are to be used primarily for increasing collective welfare—such as housing and day-care centers—in the enterprises and secondarily to be used for bonuses to outstanding workers. Many of these measures have been in operation on a trial basis for only a short time and evidence so far received suggests that these changes are having mixed results. On the one hand, bonus systems have contributed to increased labor productivity in those enterprises where they accrue to individuals or small groups of workers. On the other hand, provision of cash awards to collective groups—for example, to all members of an enterprise—have admittedly been poorly received and have created discontent.

In addition to specific incentives to producers, government policy currently continues to emphasize improvement in the quality of life in urban areas. Funds are being made available for construction of new housing and renovation of old living quarters. The improvement of urban services—public utilities, restaurants, retail sales outlets, household goods repair shops—is also being pushed, in part through encouraging the formation of new establishments and in part through allowing service entities to retain a larger portion of their revenues when they meet quality and performance standards. The expansion of the services sector has the additional advantage of providing new jobs for those younger people in the cities who cannot be absorbed in industry.

In addition to increasing incentives, Beijing's attempt to raise productivity also includes experimenting with changes in industrial organization and management in order to make the structure of production more efficient. These experiments include encouraging specialization of production by factories to eliminate the wasteful tendency for factories to ensure their sources

of supply by producing their own machinery and other input requirements. Corporate forms of industrial organization are also being tried. In these, government ministries and bureaus set overall policy and goals and their subordinate industrial and transportation corporations are given the main responsibility for and control over the task of production. The regime seems particularly enamoured of the uses of legal contracts in these new systems. Within the framework of overall state-set goals, the contracts specify details of how and when goods are to be produced and delivered among supplying, producing, and marketing units and stipulate financial penalties for nonfulfillment of contract provisions.

New systems of management are also being introduced. Chief among these is the elimination of management by committees often composed of nontechnical outsiders. In its place the old "single-head" system has been reinstituted in which technically qualified factory and enterprise directors are responsible for day-to-day operation of plants and are only generally supervised by party authorities. At lower levels of plant operation, the regime has also continued to experiment with worker election of their workshop leaders, section chiefs, and shift foremen. Given prospects of greater rewards for increased productivity, these groups presumably will elect individuals who are believed to be most competent to lead the work effort.

These changes in incentive and in management and organization policies are clearly based on assumptions that the productivity of both the Chinese labor force and of PRC industrial and agricultural capital is much lower than it should be. PRC discussions of industry have pointed out that in recent years the growth of the industrial labor force and the rates of addition to industrial capacity have been higher than the rate of increase in industrial output. Discussions of agricultural productivity similarly point to the fact that although supplies of industrial inputs to agriculture such as chemical fertilizer, tractors, and irrigation equipment have grown sharply in recent years, agricultural production has only barely exceeded population growth. Not enough information is available to independently test the truth of these propositions. The available material does suggest, however, that in the short run higher rates of production are possible for agriculture but improbable for Chinese industry.

In agriculture, the rapid rise in supplies of chemical fertilizer, in stocks of powered irrigation equipment, and in the tractor park since 1970 apparently have not had great effect on agricultural production (figure 1). Poor growing conditions, particularly in 1976 and 1977, have been a major factor in offsetting the influence of these inputs on production. Nevertheless, the high costs of such inputs relative to the low prices paid by the state for farm products, coupled with higher level strictures on the the use of inputs by production teams, have almost certainly meant these inputs have not been efficiently used. The current effort to remedy these disincentives is leading to more efficient use of these inputs; consequently, sustained if modest increases in production appear possible.

On the other hand, there is little information that would bear out the Chinese contention that large amounts of unused capacity exist in industry. The leveling out of the rate of growth of industrial production since 1978 (figure 2) suggests that large increases in output are unlikely to be forthcoming over the next few years. Further, the Chinese quest for increased production through more efficient use of existing industrial capacity faces two major obstacles. The first is the experimental nature of new organizational and management policies which so far have affected only parts of the industrial establishment. The second major obstacle is the resistance of the ponderous Chinese industrial bureaucracy to the innovative changes the central leadership is attempting to bring about. There is ample evidence that the staffs of industrial organs, from the ministry level down to individual industrial enterprises, resist these changes as profound and perhaps personally damaging departures from longstanding ways of doing things.

An important element in all these changes is the Chinese leadership's decision, formalized at the December plenum, to diminish the scope of CCP organizational involvement in factories and to limit the time available for political meetings and similar activity. The latter limitation comes under the so-called "five-sixths" rule under which scientists, technicians, and intellectuals, as well as factory hands, are

Figure 1

China: Agricultural Inputs and Production

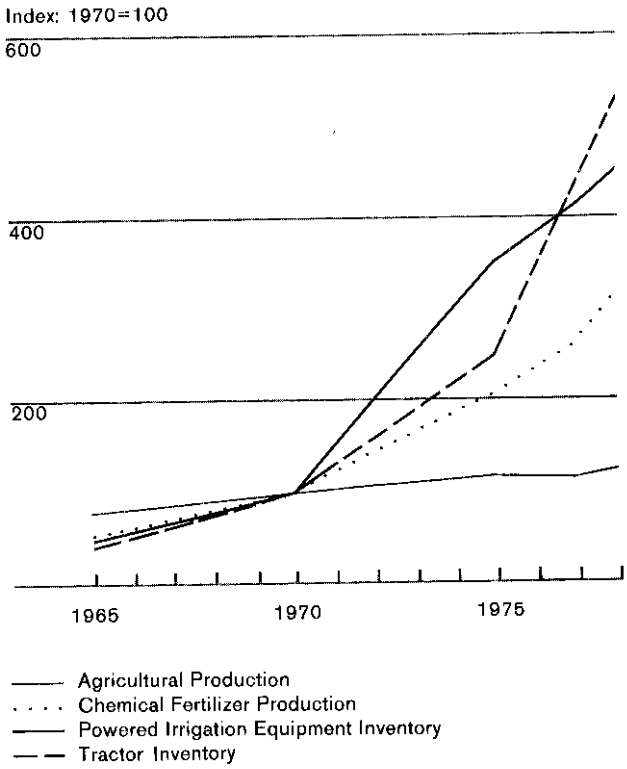

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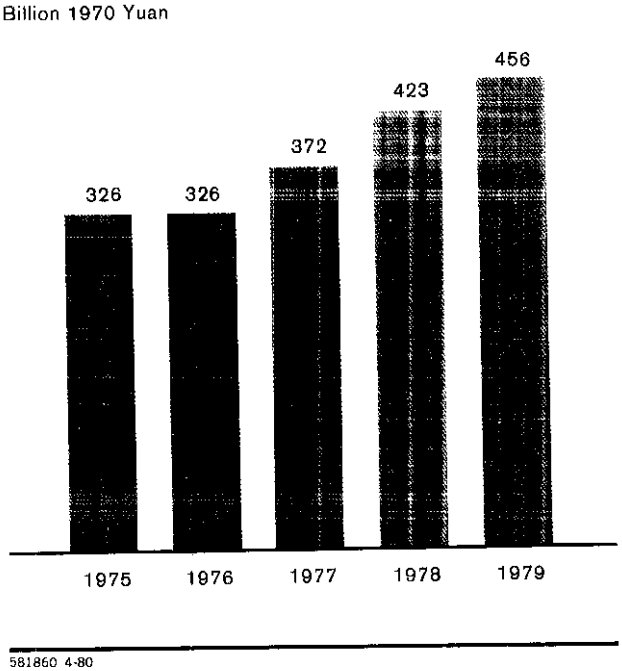
Figure 2

China: Industrial Production



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supposed to devote five-sixth of their labor to their professions and/or production and only one-sixth to political meetings. The leadership clearly believes that cutting back political activity in the enterprises, coupled with the placing of responsibility for production on individuals under a system of rewards for success and penalties for failure, will lead to better use of existing PRC plant and labor. The quest for greater efficiency has been underlined by publicizing the removal of inept managers, the suspension of production in individual plants, and the permanent closure of still other plants for failure to meet production goals, for turning out below-standard products, and for excessive consumption of energy and raw materials.

During 1979 Beijing also bolstered the emphasis on increased productivity and efficiency by restoring the banking system to its traditional role as a major economic control and auditing arm of the central government. Supervision of factory financial matters by the People's Bank, which handles the revenue and expenditure of enterprises and provides loans for working capital, has been tightened up. The Bank's financial powers are already being used to withhold loans from inefficient producers and to rectify abuses of the incentive system by refusing to release funds for bonuses judged to be excessive. The central government has also moved to ensure that state funds for agriculture and for capital investment are more productively used by reestablishing the Agricultural Bank (abolished in 1965) and by strengthening the operations of the Construction Bank. The funding of investment through the Construction Bank is being changed from the old system of outright grants of construction funds for projects to a system where the

Construction Bank judges the wisdom of proposed projects, monitors their progress, and extends funds as loans with interest charges which must be repaid.

Short-term Prospects. The economic policies pursued by the Chinese leadership since the December plenum constitute an unparalleled appeal to the individual interest of the Chinese people. Even though these policies have only begun to take hold they are already engendering new problems for the regime. In agriculture, for example, the strengthening of the decision-making power of the production teams has periodically led to disbandment of the teams in a few areas and a division of collectively owned farm tools and farm lands among individual farmers. The government has moved quickly to eliminate these isolated reversions to household farming—which prevailed prior to the 1955 cooperativization of agriculture—by reasserting production team and brigade authority over such activity. The regime similarly is finding that production team decisions on what they plant do not always accord with state cropping and procurement plans, particularly for the important cotton crop. The government is also having trouble controlling the operations of rural free markets, or village fairs, where both agricultural products and consumer goods are traded at market rather than state-set prices. Strong demand and higher prices in these markets periodically divert goods away from state procurement and distribution channels.

Aside from the use of the banking system to stop the "reckless" award of bonuses in excess of gains in industrial productivity, the government has also found that the additional leeway given to factory managers and enterprises is stimulating "unsocialist" activities that undercut the state material allocation and distribution systems. New restrictions have been placed on the operations of small, illegal factories and suppliers that are often able to provide needed goods more quickly to enterprises than is the cumbersome state supply system.

The leadership has moved promptly to keep these activities within bounds and probably will continue to be able to limit their economic consequences. Nevertheless, some of these departures from past practices provide an opening for those unhappy about the pragmatic cast of present policy to criticize the leadership. Sensitivity to this issue has been amply documented by the continuing series of "study sessions" conducted throughout the party and the PLA (People's Liberation Army) to defend the correctness of the economic policies adopted at the Third Plenum.

Rising consumer expectations now are a problem of the first magnitude for the government. Notwithstanding repeated insistence that consumer welfare can be improved only gradually and should be preceded by increased productivity, the new policies have stimulated long-suppressed popular demand for more and higher quality food, clothing, housing, and consumer durables. One indication of the strength of this demand is that despite low interest rates urban and rural bank savings have steadily risen over the past two decades. The size of these deposits is unknown, but they are clearly large enough to have become a serious concern for the government. On 22 March the PRC abandoned the old system of a uniform annual interest rate of 3.2 percent for fixed deposits regardless of term and installed a system of six-month, one-, three-, and five-year time deposits. Interest rates on all deposits were also increased from 3.6 percent (for six-month deposits) to 5 percent (for five-year deposits). In addition to inhibiting the withdrawal of funds from these accounts, the higher interest rates are also intended to attract more of the increased money income that is beginning to be received by the population.

Other indications of the force of consumer expectations are reflected in disapproving press comment on greater worker concern for their "lifestyles" than with production and on conspicuous consumption of food and drink. A number of observers have noted the gradual shift in the dress of the urban population from the uniform drabness of the past to varied styles and better quality clothing. Still others note the avid interest of many urban consumers in acquiring wristwatches, bicycles, and televisions, often through "backdoor" or black market transactions.

Meeting this demand will be an acute problem for at least the next several years. Industrial production began to slow in 1979 as the economy emerged from the recovery of 1977-78. The new incentives policies and more efficient organizational and management measures have not been in place long enough to have had much effect on industrial output. While these

policies may indeed lead to some increases in output over the next few years, they will only partially remedy the more fundamental problems of industry. These are the constraints associated with past periods of Chinese industrial expansion—shortages of coal and raw materials, overburdened transportation systems, and insufficient electric power—which are the outgrowth of past investment decisions. During 1979 the government has increased investment in these troubled sectors, particularly in energy and transportation. Nevertheless, construction of new capacity in these areas will take between three and five years to accomplish. Thus, a significant loosening of these constraints in the short term is not in the offing.

In addition to generating increased output in the short run from essentially fixed industrial capacity, the leadership faces a serious problem in adjusting the mix of industrial output, primarily in the area of consumer goods production. The PRC set the 1979 target for growth in the value of industrial production at 8 percent. In a striking departure from past practice, the target for heavy industry (7.6 percent) was planned to be less than that for light industry (8.3 percent). At yearend the PRC announced that the total industrial output target had been met, that heavy industrial output had increased by 7.4 percent, and that the light industrial target had been overfulfilled, with output increasing by 9 percent. However, Beijing also admitted, in several December 1979 discussions, that the increase in the supply of consumer goods still fell far short of the increased demand for such goods generated by higher incomes in both urban and rural areas. Moreover, examination of components of light industrial production suggests that the annual target had been met more through increased production of such high value commodities as TV sets, sewing machines, and bicycles than through production of such basic and lower value goods as clothing, soap, and household furnishings.

Further, the production of consumer goods still is not oriented to popular wants nor is it of acceptable quality. As in the past, a question remains as to how much of this production actually is sold and how much accumulates in warehouse stocks. This problem underlies continued government attempts—through encouraging improved market research by and the use of contracts between producers and marketers of consumer goods—to ease this situation. This is a new and exceedingly complicated management problem for both the government and industrial producers. Thus, progress has been slow and their efforts will not quickly meet the expectations of Chinese consumers.

Nevertheless, the attempt to meet rising consumer expectations quickly, albeit only partially, and to increase export earnings got off to a good start in 1979, in the main because of improved agricultural performance. Foodstuffs account for about one-half of consumer expenditures in the PRC and a large share of the raw materials used in light industry come from agriculture. Another record harvest of grain (over 315 million tons) and respectable increases in most nongrain crops, except cotton, are allowing almost immediate increases in food consumption and provide the basis for increased output of consumer goods in 1980. The leadership should be able to cite both concrete improvements in consumer welfare and an expanded capability for paying for imports in defending the correctness of its policies.

The relative political stability that has prevailed since the fall of the Gang of Four in 1976 has immensely facilitated the leadership's attempt to grapple with these complex problems of demand and supply. The regime can demonstrate initial results from the first year of these short-term policies and serious threats to political stability have, for the moment, diminished. However, the leadership also recognizes that more time will be needed for the new policies to take hold than was originally expected at the time of the Third Plenum. Deng Xiaoping has been reported in the press as having told a group of overseas Chinese in September and the president of *Asahi Shimbun* in October, that the "readjustment" period might be prolonged.

As for the pattern of growth over the next few years, we suspect that GNP will fall off from the annual 6 percent rates of the past to around 5 percent. Moreover, the sources of growth will also change with industrial growth slowing, perhaps to around 6 to 7 percent per year, and agricultural growth picking up significantly to something on the order of 4 to 5 percent per year. While foreign equipment and technology will continue to flow into the PRC at higher rates than in the past mainly because of China's $7 billion worth of

purchases in 1978, deep-seated problems in absorbing such imports will be ameliorated only slowly. Absorption problems coupled with the general cutback in investment plans are largely responsible for the sharp drop in China's whole plant purchases in 1979 to $1 billion. With the exception of imported chemical fertilizer plants, foreign technology is unlikely to have much of an impact on production during this period.

Meeting the expectations stimulated by the new policy course will remain a constant and major concern for the leadership. Failure would increase popular discontent, with consequent adverse effects on productivity, and would make wholehearted participation in the modernization effort even more difficult to achieve. More important is the impact of failure within the CCP. Apparently large numbers of CCP rank-and-file cadres continue to have little enthusiasm for implementing policies that sharply differ from their past experience. These may become even less responsive to central direction than they now are. Moreover, if these policies do not succeed, the ability of those within the party who resist the pragmatic cast of current policy to challenge the dominant leadership will be greatly strengthened.

The outcome of these short-term policies cannot be predicted with assurance. On balance, the odds favor their success because they embody an unprecedentedly rational approach to China's economic problems. Compared with the Maoist era, the present leadership appears to be much less bound by ideological constraints in its policy choices and more thorough in thinking through the probable outcomes of new policies, and is clearly able to react quickly to the new problems that arise. Moreover, this rational approach is also manifest in their treatment of longer term development policies. Even though these policies do not have direct and immediate impact on the Chinese economic process, they complement the operation of shorter term policies and are crucial for the overall modernization effort.

The Fifth Modernization

The present emphasis upon readjustment and the flux in long-term economic planning obscures measures being taken by the leadership to bring about a fifth modernization—providing the political and social prerequisites for economic modernization. New impetus was given to this effort by the consolidation of political power in the hands of Deng Xiaoping and his associates at the Third Plenum of the CCP in December 1978. Since the Plenum this effort has centered on four major tasks: reshaping and strengthening the Chinese Communist Party as the fundamental instrument of political power, attempting to establish some semblance of the rule of law within society, continuing to upgrade the Chinese educational system, and intensifying programs for slowing population growth.

The Party and the Maoist Legacy. Reshaping and strengthening the CCP is aimed at making party organizations and members more responsive to direction from the central leadership and at narrowing the scope of party operations within society. Most of the weaknesses in the CCP are the direct result of actions initiated or condoned by Mao Zedong between the Cultural Revolution of 1966-67 and his death in 1976. The events of these years debilitated the party organization and demoralized most of its older members. In 1967 the CCP apparatus was incapacitated by the Red Guard movement to the point where the PLA had to be used to restore order. Party affairs were thereafter dominated by Mao's sycophant Lin Biao until Lin's death in 1971; subsequently the party's effectiveness as the instrument of rule was further diminished by the factionalism that marked the era of the Gang of Four and the struggle for the succession to Mao.

During this period, party membership roughly doubled from the 17 million members of 1967 to more than 37 million in 1978. An unknown but clearly significant number of these entered the party without going through the established system of personal recommendation by CCP members, probationary periods, and review of qualifications by party organizations at the next higher level. For as much as half of the current CCP membership, mass movements, inner-party factionalism, and freedom to operate with a minimum of control from above have been the accepted norms of party work. For Deng Xiaoping and his colleagues the party organization is a poorly disciplined instrument containing a sizable segment of cadres who either do not understand or who disagree with many of the new policies introduced by the leadership. Further, to the

degree that both these newer members and the older, pre-Cultural Revolution generation of members are wedded to Maoist ways, they constitute a potential reservoir of support for any higher level leader attempting to reverse Deng's policies.

Measures to remedy these problems were undertaken at or soon after the Third Plenum in December 1978. Deng Xiaoping's control over the central organs of the party was strengthened by the appointment of his protege, Hu Yaobang, as Secretary General of the party and the naming of another long-time associate, Song Renqiung, as head of the Organization Department of the CCP, the organ responsible for personnel assignments. Reestablishment of the party's Commission for Inspecting Discipline by the Plenum also underlined the leadership's strong interest in seeking out and punishing violators of party rules and regulations. Additional weight was given to the Commission by the appointment of senior party figure Chen Yun to head the Commission. Chen, who was restored to his position as vice-chairman of the party and member of the standing committee of the Politburo at the Plenum, was a major figure in the party rectification movement of 1942-44 and is the leader most closely associated with the pragmatic economic policies of the First Five-Year Plan period and the early 1960s. The Commission has not so far been used to undertake "rectification" of the party membership by purge and indoctrination on the scale of the 1942-44 campaign. Nevertheless, since May 1979 a low-key rectification campaign has been under way featuring increased attempts by Discipline Inspection Commissions at ferreting out past and current violations of party rules and a strengthening of Organization Department work in CCP organs. These organizational measures have been accompanied in recent months by repeated study sessions, particularly for higher level CCP and PLA cadres, aimed at making up "missed lessons." These sessions are intended to rectify footdragging and opposition on the party of CCP members to the new economic policy course announced at the Third Plenum.

The problem of the refusal of lower level organs to comply with Central Committee directives was strikingly illustrated in November and early December 1979. A *People's Daily* editorial of 5 November revealed that local authorities still had not complied with the April 1979 orders to suspend or defer uneconomic and impractical capital construction projects. A 23 November *People's Daily* article singled out this noncompliance with central directives as a major contributing factor to the "slow progress" of readjustment. Subsequently, several *People's Daily* articles explicitly called for "obedience" to Central Committee decisions and implied that strong sanctions would be imposed if such obedience were not forthcoming.

In addition to attempting to make the CCP membership a more responsive and efficient vehicle for implementing the policies of the center, the leadership is also attempting to direct CCP activity into lines that will facilitate economic modernization. In line with the Plenum's announcement that the work of the party had been shifted from political struggle to economic modernization, CCP political work has been cut back from past levels and its content has been changed to emphasize economic productivity and reliance on material incentives. Similarly, the dispatch of CCP "work teams" from higher levels down into factories and farms both to conduct political campaigns and to exhort workers to greater effort, has also been cut back. This hallmark of the Maoist era has been pushed aside on grounds that the burden of feeding and housing these groups at the working level is too heavy, that they tend to disrupt rather than stimulate production, and that they undercut the authority of local CCP cadres at the working levels.

In restricting those party activities that have proven counterproductive in the past, the Dengist leadership also appears to be groping its way toward a firmer differentiation between party and government functions. While the absolute supremacy of the CCP in formulating policy remains unchanged, more latitude and greater responsibility is to be given to nonparty organs in the implementation of policy. The problem is one of the bureaucracy that has grown up over the past decade as party committees at every level became the sole organs for making decisions on all questions no matter how small. In effect, the party has become a source of bottlenecks that stifle innovation and initiative in political and economic work.

Preliminary steps toward breaking this bottleneck are evidenced in the prominence now being given to nonparty organs—people's government organs at provincial, municipal, perfectural, and county levels—in the governing process and the concurrent trend toward playing down the role of CCP secretaries and committees in the operations of these organs. In some areas, provincial party committees have also begun to disband or reduce the staffs of party bureaus and sections, transferring many of their functions back to government organs.

How far this process, which is analogous to the experiments with "one-head" management in industry, will go is not yet clear. However, the damages brought by excessive party interference in economic and other matters in the past plus the immensity of the task of governing 1 billion people and managing an increasingly complex economy may be leading the leadership toward a system that may eventually resemble that of the Soviet Union; that is, the development of a separate and equally ponderous government bureaucracy alongside that of the party. In such a system, clearer distinctions should begin to appear between party members whose main occupation is party work—the apparatchiks—and those who, while they are party members, are specialists in government and economic organs. The current effort and attendant publicity on the recruiting of scientists and technicians into the CCP may be a precursor of this trend as well as the attempt to enlarge the proportion of general administrative and specialist cadres "of all trades and professions" within the party. In an environment in which economic modernization is the paramount objective, a government bureaucracy staffed by technocrats may eventually become a more important factor in Chinese politics than heretofore has been the case.

Lastly, the attempt to make the CCP a more efficient instrument for modernization also includes exposing party members at all levels to the contrast between China's backwardness and the advances made in the industrialized world. In addition to the travels of the top leaders themselves, including Hua Guofeng and Deng, large numbers of provincial party figures have traveled to the developed world as part of PRC delegations. Many of these officials have subsequently convened provincial forums to present their observations and conclusions. A number of provinces and municipalities have also held conferences of party and nonparty figures to hear the experiences and suggestions of scientific and technical personnel who have also gone abroad as members of various Chinese fact-finding and negotiating teams. Members of the CCP in urban areas are being exhorted to study and attend courses intended to help them understand science, technology, management, economics, and foreign languages. In rural areas, similar efforts are under way to educate party cadres in scientific farm management. The magnitude of the problem of educating the rural party rank and file may be particularly difficult if conditions in the countryside are similar to those in one county of Guizhou Province. In this county more than half of the party branch secretaries at the brigade level are illiterate and only one-third of commune and brigade party cadres have enough arithmetic to balance farm accounts.

In many respects, PRC chances for accomplishing the "four modernizations" over the long run pivot on the success of the leadership in remolding the CCP. For the moment, Deng Xiaoping and his colleagues seem secure from challenges to their leadership from within the top levels of the party. Nevertheless, the tasks of expunging Maoist work styles and the "lingering fears" of many cadres that present policies may be abruptly changed as well as the tasks of disciplining and educating the party membership to the point where they can intelligently carry out policies for modernization are difficult and will not be accomplished overnight. If the party as the supreme political institution and as the main instrument of policy cannot be modernized along these lines, the prospects for accelerating modernization of Chinese society in general and the economy in particular are not promising.

The Rule of Law. The instability and disorder of Chinese party affairs over the past decade has clearly had its counterpart in society in general. If only a fraction of the voluminous reporting of past injustices suffered by the Chinese population are true, then the relationship between the rulers and the ruled must have reached a new nadir at the time of Mao Zedong's

death in 1976. Increased incidence of crime, cadre corruption, arbitrary arrest and expropriation of personal property, and capricious official actions in civil and criminal cases all apparently contributed to a general deterioration in the quality of life in the PRC. The primitive state of Chinese legal codes and legal institutions and their consistent subordination since 1949 to the dictatorial authority of the CCP did little to mitigate the situation.

For the Dengist leadership, restoration of some semblance of law and order is important to the modernization process. First, the use of law to provide an orderly and more secure environment for the population is a fundamental requirement for evoking popular response and support for the modernization effort. New laws, and institutions to enforce them, are needed if the leadership's new economic policies particularly regarding foreign investment and business operations in China and the use of contracts in domestic economic activity are to be effective.

Although a new constitution was promulgated in March 1978, the PRC's second in three years, little progress was made in developing new legal institutions and legal codes until after the December 1978 Plenum of the CCP. On the institutional side, staffing of the revivified people's procuratorial organs and the system of people's courts picked up momentum in 1979. The functions of these organs are to limit the powers of police and security organs regarding investigation and arrest and to ensure an orderly and fairer disposition of criminal and civil cases. Movement in this area has been slow in part because many of the PRC's small number of trained lawyers have been forced into other occupations over the past decade and, in part, because legal work is not viewed as a desirable occupation. This last difficulty arises mainly from the past vulnerability of workers in the legal system to political attack and to charges of "rightism." In at least one province, Heilongjiang, the absence of court buildings and inadequate funding is also holding back the formation of legal organs. In addition, the process of setting up these organs is also being slowed by the reluctance of party committees to loosen the dominance over legal matters they have maintained over the past 10 years.

As for new laws, the main achievements appear to be the promulgation of a joint Chinese-foreign investment law, a criminal law, a criminal procedures law, and organic laws for the people's courts and procuratorates, which came into effect on 1 January 1980. These laws, coupled with the reactivation of procuratorial and court systems, are intended to promote order and stability within society by providing at least a rudimentary assurance to the population that enforcement of the law will be more equitable than in the past. Only preliminary work has been undertaken on making other aspects of the Chinese legal system more supportive of the modernization effort. An eight-year plan (1978-85) for the study of law was adopted at a national legal conference in March 1978. While this plan covers research into every facet of law, its focus on completing legal studies and compiling textbooks and dictionaries of legal terms implies that the process of modernizing law is only beginning.

In the meantime, the lack of progress in revamping systems of Chinese business law remains a constraining factor in modernizing the economy. The concern of foreign businessmen for protecting patents covering equipment and processes shipped into China has not been allayed by PRC assurances that a new patent law will be forthcoming in the near future. The new joint venture law has only partially facilitated PRC overtures to foreign firms for new investment. These efforts continue to be hampered by vagueness in Chinese terms regarding ownership, taxation, and the means of remitting profits from such investment out of the country.

Domestically, the regime's experiments with using a system of contracts between producers, distributors, and consumers to ensure efficient provision of goods and services are unlikely to be effective in the absence of some overall system of contract law. The questions of how the terms of such contracts will be drawn up, how disputes over contract provisions will be adjudicated, and who will levy penalties for nonfulfillment have been under continuing discussion within China. In early 1980, the President of the Supreme Court, Jiang Hua, noted that "economic divisions" had been

established at higher court levels and that similar organs would be set up under lower courts throughout China. These "economic divisions" apparently are similar to the courts for economic cases set up in the city of Tianjin in late 1979. In addition to handling violations of pollution regulations and prosecuting assorted economic crimes, Tianjin's economic courts also hear cases of nonfulfillment of contracts. The courts, however, will hear such cases only when contract disputes cannot be successfully arbitrated within and among the government hierarchies having interest in the issues. This implies that putting the new system of contracts into effect will be a slow and cumbersome process. Such a process will negate much of the new efficiency which the contract system is supposed to bring to PRC production processes.

The Dengist leadership faces several problems in attempting to establish systems of law and order akin to those that are part of the fabric of the developed world. The grafting of essentially western legal concepts and institutions on traditional Chinese society is a task that has frustrated Chinese reformers for over a century. The Chinese preference for settling disputes through private arrangement of differences between the parties concerned rather than through public adjudication by outside authorities remains strong in the PRC. The task is also made more difficult for the present leadership because the bulk of Western legal tradition is based on concepts of personal equality before the law and representative democracy which are unknown under a Communist political system. The PRC appears to be slowly developing a system that incorporates many of the characteristics of Western legal systems but one in which the CCP remains the supreme arbiter of justice. Even small progress in this area will be useful to the leadership in enlisting the support of the population, in encouraging the flow of foreign resources into the PRC, and in installing more modern systems of economic management.

Educational Policy. The crucial role of education in facilitating both the absorption of modern science and technology and the broader task of bringing modernity to a backward rural society has been a consistent concern of the Chinese leadership since the fall of the Gang of Four in late 1976. While educational policy has been focused primarily on remedying the effects of the 10-year hiatus in formal education and replenishing the supply of trained scientists and technicians, the Dengist leadership has also given important attention to the long-term effort to raise urban and rural education levels in general. In working out policies of readjustment and scaling back some of its more ambitious economic plans since the December Plenum, the leadership has so far continued to emphasize education in the modernization effort.

One step in the process of developing education was the January 1979 decision to expand institutions of higher learning by almost 30 percent. This decision gave the go-ahead to provincial and municipal authorities to establish 153 new institutes and colleges and to reopen 16 that had not functioned for some years. The categories of school envisaged reflect the push for more trained scientists and technicians—46 schools of engineering, 18 medical schools, 13 schools specializing in agriculture, forestry, veterinary medicine and meteorology, and 10 economics and financial institutes. Moreover, the list also reflected a strong commitment to overall improvement of the educational system by establishing 77 new teachers colleges to meet the needs of secondary education.

These 169 new schools will constitute a third track in the PRC system of higher education and as such their development will be slow. At present the 88 "key universities"—model schools that train the best students, have the best teachers, and set standards for first-rate academic work—receive the highest priority in allocations of resources to higher education. The remaining 500 existing universities and colleges appear to have a lower priority. In these schools insufficient numbers of qualified teachers, shortages of school buildings, and inadequate supplies of books and equipment are particularly acute problems. The needs of existing schools almost certainly will mean that the new "third track" schools will come into being only slowly and will not be able to provide quality education for many years to come.

Nevertheless the decision to establish these schools is a strong indication of leadership interest in preparing the ground for modernization and will eventually help to place the increasing numbers of middle school graduates who would otherwise have no opportunity for further education. This past fall the PRC was able to

enroll less than 1 million of 7 million 1979 middle school graduates. The potentially disruptive problems of disaffected and partially educated youth are not limited to the 6 million who did not gain entry into college this past year. An unknown but clearly large number of older candidates—those who could not enter during the period when university-level education was suspended or whose training in politicized middle schools is weak, as well as those who have been in rural areas as part of the "down to the countryside movement"—also remain frustrated by their lack of access to higher education. The leadership has admitted that there are no acceptable short-term remedies for this problem. However, a concerted effort is being made to steer those who will not be accepted by the college system into vocational schools and into jobs in factories and agriculture where their education can at least partially be continued through correspondence courses and other forms of spare-time education.

The universal emphasis upon China's backwardness and the need for all to learn more modern ways is not narrowly limited to training a new generation of scientists and technicians. Correspondence courses, short full-time training programs, lecture series, and TV and radio courses for workers, industrial and commercial cadres, and secondary school teachers have proliferated over the past year. A host of subjects is covered: simple arithmetic and reading, principles of chemistry and physics, international affairs, industrial management techniques, and English and Japanese language courses. At a more general level, provincial and municipal radio broadcasting schedules continue to be changed to include more programing on cultural, artistic, and historical matters as well as on scientific and technical subjects. Similar liberalizing patterns are also apparent in book publishing and in the resurrection or introduction of new academic and more general periodicals. These policies and programs primarily affect urban areas. Nevertheless, parallel efforts are under way in rural areas, mainly through upgrading primary and secondary schools and providing rotational training courses for rural cadres and spare-time education for peasants. Illiteracy—Beijing recently noted that almost 100 million peasants are in this category—and the high rate of school dropouts have been singled out as particularly serious problems in rural areas.

In all these areas, as in the formal school system itself, the time and other resources devoted to political and ideological matters has been reduced to the point where the central leadership has recently been forced to reassert the virtue and necessity of political study and correct ideological content in educational and cultural matters. The impressive aspect of these policies is that while the recent tightening of ideological standards and the reallocation of scarce resources have apparently slowed the liberalization of cultural life and the expansion of the educational system, the leadership has not abandoned the effort.

The perils of these policies are well understood by the leadership. Containing the dissatisfaction generated by large numbers of young people whose newly whetted appetites for higher education cannot be appeased will be a recurrent problem for years to come. Moreover, other problems will arise because these policies run directly counter to fundamental Maoist tenets. Most of the Maoist commitment to preventing the emergence of a managerial-bureaucratic elite and to minimizing the differences between intellectuals and factory labor, between workers and peasants, and between the urban and rural segments of society will gradually be eroded by these policies. Like the parallel effort with incentives policies, unless managed carefully the growth of these differentials will lead to the formation of disaffected groups who provide a latent source for political manipulation and consequent instability. Since both their policies for modernizing China and the maintenance of their political positions depend upon minimizing instability, Deng Xiaoping and his colleagues are likely to remain highly sensitive to these problems.

Population Control. Policies aimed at eventual easing of the pressure of population growth on China's limited resources have been reaffirmed and reinforced by the leadership since the December 1978 Plenum of the CCP. After sporadic efforts to promote birth control in the 1950s and 1960s, the PRC adopted a more open and forceful approach to the problem in 1973. Despite setbacks attributed to the succession struggles of 1976, between 1973 and 1978 more coercive policies appear to have led to a one-third drop in the rate of population growth, from 2.3 percent in 1973 to 1.5 percent in

1978.[3] Evidence of the leadership's strong interest in further decreasing population growth rates was provided by the inclusion of government advocacy of family planning in article 53 of the new PRC Constitution of March 1978 and Chairman Hua Guofeng's call in the same month for reduction of the growth rate to less than 1 percent by 1980.

The Third Plenum further raised the priority of family planning by formally approving measures decided upon in late 1978. The most important of these measures appears to have been the imposition of a new system of economic rewards and penalties aimed at cutting the birth rate. The system promotes the standard of one child per couple as ideal, permits two children per couple and penalizes couples who produce three or more children.

Under trial regulations put into effect by various provinces and municipalities during 1979, rewards for "one child" families are to take the form of child care allowances paid to the parents until age 16 and waiving of charges in child care centers and miscellaneous school fees for such children. These couples are also to be given preference in obtaining housing and in the allocation of private plots in rural areas. The traditional Chinese belief that security in retirement is guaranteed by a large number of children is also addressed in these regulations. Retired "one child" couples are supposed to be given augmented retirement pensions.

Penalties for couples bearing three or more children include docking of the wages or work points of each parent by, in the case of Shanghai, 10 percent for each child born beyond two until such children reach age 16. Such multiple child families also are to be denied additional housing and expanded private plots when these become available. Expenditures for the rewards program are to be paid by the welfare funds of the place of employment or local authorities and revenue from the penalty system is to go into such welfare funds.

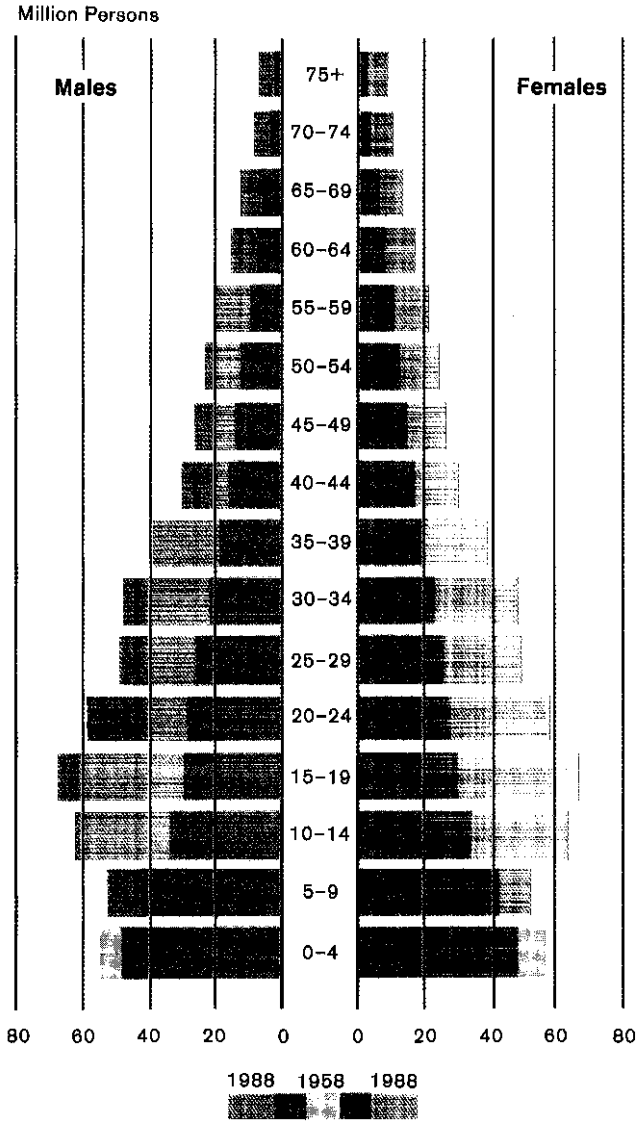
[3] A detailed appraisal of population policies and the problems of measuring population growth in the PRC is contained in J. S. Aird, "Population Growth in the People's Republic of China," Joint Economic Committee of Congress, *Chinese Economy Post-Mao*, 9 November 1978, pp. 439-475.

Other provisions of the program are the prohibition of marriage to college-level students and to workers during their apprenticeship periods on pain of expulsion. Rewards, in the form of cash and time off from the job, are also provided for married couples who undergo sterilization.

The new measures to reduce population growth are driven by Beijing's recognition that the demographic factors favoring significant increases in growth rates have become stronger. The number of women in the child-bearing ages began to rise sharply in the 1970s and this trend will continue through the 1980s (figure 3). In addition to using economic coercion to prevent a potentially rapid rise in the birth rate, the regime is also giving unprecedented publicity to the burdens population growth place on food supplies, job opportunities, educational facilities, and housing. Similarly, the costs to both parents and the state of bringing up and educating children is also receiving more emphasis.

The obstacles facing the leadership in ameliorating China's most fundamental problem are sizable but not insurmountable. Success in curbing population growth pivots on eliminating resistance to planned parenthood in the rural areas. Part of this resistance is grounded in economic factors; for example, grain distribution is largely determined by the size of family. Firm implementation of the new system of economic rewards and penalties—in particular, the docking of work points for multiple children families in rural areas—could measurably diminish the economic incentives for large families. Changing traditional rural values, for example, the strong preference for male children both to augment family labor power and for support in old age, will be a much slower process. Improved educational levels and the growth of closer cultural and economic links between rural and urban areas—all embodied in or implied by many of the regime's new policies of modernization—are likely to facilitate this process. Nevertheless, both the implementation of the "one child" program and the effort to change the traditional Chinese attitudes toward family limitation depend for their success upon the thoroughness and persistence with which party and government cadres prosecute

Figure 3
China: Comparison of Age-Sex Distributions, 1958 and 1988



The comparison of 1958 with 1988 shows changes in the age-sex distribution of the Chinese population, some of which are now only beginning to be apparent, but will be much more evident ten years hence.

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them. Half-hearted application by lower level cadres of these often unpopular policies has hampered the effort in the past. Whether this continues depends upon how successful the leadership is in the task of making the CCP a more responsive instrument of central control. At present, cadres are being exhorted to become "models" in family planning and instances where cadres themselves have been prime violators of these policies are being given publicity as "negative examples" for the rest of society.

Some years must pass before the impact of these new measures for slowing population growth becomes apparent. In any case, there is almost no chance that the PRC will be able to meet the announced goal of reducing population growth rates to 1 percent this year and to half of 1 percent by 1985. Current estimates suggest that the rate will not fall to the 1-percent level until late in this decade. Nevertheless, the evidence suggests that the current leadership is committed to diminishing the hazard that continued population growth poses to eventual economic modernization.

All of these tasks, summed up above under the rubric of the "fifth" modernization, are fundamental elements in creating the political, social, and cultural infrastructure required for sustained economic modernization and growth. Perhaps the best illustration of Chinese understanding of the close relationship between all five "modernizations" is contained in Ye Jianying's 30th anniversary speech of September 1979:

> *By the four modernizations we mean the four major aspects of modernization and not that modernizing is confined to these four aspects.* Along with the reform and improvement of the socialist economic system, we will reform and improve the socialist political system and develop a complete socialist legal system. While building an advanced material civilization we want to raise the educational, cultural, and health levels of the whole nation . . . and thus build an advanced socialist civilization. *These are important objectives as well as necessary conditions for the realization of the four modernizations.* [Emphasis supplied.]

Nonetheless, these problems are not susceptible to quick or easy solutions. Years of consistent and patient effort by this leadership and its successors will be required before these elements begin to reinforce, rather than hamper, Chinese economic growth.

The Shape of Economic Policy, 1982 and Beyond

The experiences of the past two years appear to have given the Chinese leaders a much greater appreciation of the profound changes in political institutions, social conditions, and cultural life required for economic modernization. At least for the moment, there is also an awareness that neither hortatory campaigns of the "Great Leap Forward" type nor the mounting of grandiose but ill-founded programs similar to the 10-year plan of 1978 can be used as shortcuts to remedying China's backwardness. If there is a consensus developing among the Chinese leaders as to how the modernization effort should go in the future, it would seem to be one of continuing the pragmatic, trial-and-error approach used since the Third Plenum to meet the problems and choices confronting them.

The Chinese leadership cannot work out systematic long-term plans for the economy until the results of the current period of readjustment begin to come in. The sparse information received thus far on Chinese thinking about the next two decades suggests that agricultural development will continue to be the fundamental basis for overall economic modernization and growth. Although there have been no thorough Chinese discussions of long-term development strategies, agricultural growth apparently is deemed the point of departure for the pursuit of an import substitution program in the 1980s and 1990s. Such a program seems aimed at initially heavy use and then eventual diminution of PRC economic linkages to the outside world to create the conditions for domestically driven, "self-reliant" economic growth. The elements of this approach to development appear to be as follows:

- Maintenance of steady, if unspectacular, increases in grain production and in industrial crops while accelerating the output of nongrain foods, particularly meat products. The aim is to more fully exploit the large areas of China suitable for grazing sheep, goats, and cattle but which cannot be sown to crops except at high cost. Thus, the composition of Chinese diets would gradually shift away from grains and toward higher intake of vegetables, edible oils, and meat products, into a pattern akin to those associated with the higher income LDCs.

- As agriculture develops, the PRC apparently hopes to move to import substitution policies in the mid-1980s. This is aimed first at eventually eliminating imports of grain and other food products and natural fibers, which currently account for over 20 percent of the import bill. Export growth will continue to be aggressively pursued. Oil exports will be important but limited by domestic needs; textiles will be pushed but held down by quota systems in developed country markets. Light industrial and agricultural products will continue to be important components of Chinese exports. Export expansion may prove to be difficult to sustain because of low rates of growth in the OECD markets and the derivative effects of such low growth on China's LDC trading partners.

- As import costs for food and fibers decline and export earnings increase, PRC imports of complete plants, equipment, and technology are likely to accelerate. The pattern of such imports is likely to remain much like that of the past—spurts of purchases followed by extended periods of absorption time. New production capacity for the extractive and industrial processing industries and the transportation sector is likely to be a main component of these imports.

- Toward the end of the decade the PRC apparently hopes that imports of new industrial capacity and expansion of present domestic capacity will have diminished the importance of imports in meeting the country's need for finished and semifinished industrial materials as well as transportation equipment. These now account for over one-third of the import bill.

- The government recognizes the danger of increased balance-of-payment problems. The Chinese already can draw on almost $30 billion in firm credits and loans through 1985 and are actively seeking more for the period beyond 1985. We see no reason why they should not remain adept managers of payments problems.

An important if implicit assumption in this scheme is that investment priorities will begin to place more emphasis upon heavy industry in the late 1980s. Whether this can be done without slowing agricultural and light industrial growth depends upon such questions as the composition and size of overall economic growth during the early 1980s, whether or not the leadership has been successful in achieving momentum in the agricultural sector, and whether the government can control consumption without depressing productivity. In any case, the two major variables that affect economic as well as all other plans for long-term modernization do not change. First whether the present leadership can consolidate its hold on power and implement its present and contemplated economic policies. Their success in this endeavor is by no means assured and is further complicated by the likelihood that most of the present leadership will pass from the scene during the next five to 10 years. Second, whether the policy of placing a low priority on Chinese military modernization by linking it to the eventual development of a modern industrial base, which has been followed since February 1978, can be continued. A serious further deterioration in relations with the Soviet Union or Vietnam could lead to increased allocations of resources to the military at the expense of economic development.

Even assuming that the leadership is successful in carrying out the new course along lines similar to those postulated above, it is difficult to foresee PRC attainment of the status of a "front rank" industrial state by the turn of the century. If China's present leaders and their successors are able to finally master the food-population problem, to rectify the imbalances within industry and between industry and the other sectors, and to have begun a full mobilization of China's immense material and human resources by the year 2000, they will have done well.