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Central Intelligence Agency



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

22 March 1985

China's Urban Reforms and The Man-on-The-Street

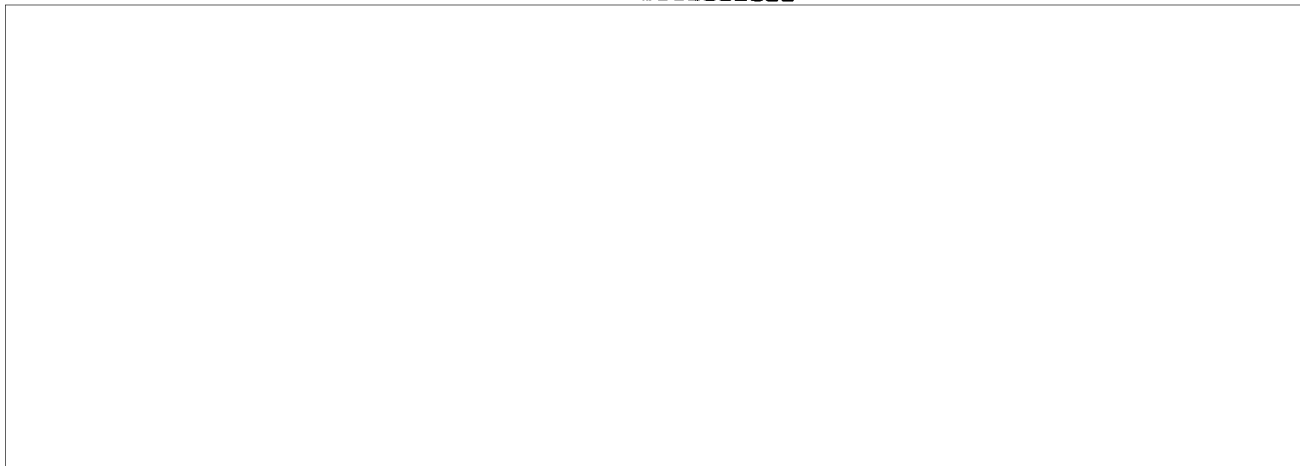
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Summary

Beijing's decision last fall to extend economic reforms to urban areas--trying to duplicate the success achieved in the countryside--has, we believe, created concern and confusion among urban workers. After decades of Maoist ideology and industrial policies, which eroded the Chinese work ethic, Beijing's reforms seem to be asking the man-on-the-street to work harder, accept variable wages, forgo automatic bonus payments, and accept job insecurity, some inflation, and possible layoffs. Moreover, the government seems intent on reducing China's elaborate system of urban subsidies, which may be equivalent to actual per capita urban incomes. In our view, many urban residents will be reluctant to support these reforms, and probably view them as threatening. Beijing, nonetheless, clearly is banking on the workers being able to reap quick results to win acceptance of its policies. Tangible results and a perception of a unified leadership committed to the policies--which we see lacking now--will be critical in alleviating the concerns of the urban worker.

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Barriers to Urban Reform

The success of China's rural reforms, which enjoyed strong grassroots support from peasants, encouraged Beijing last fall to institute similar changes in the urban economy. We believe, however, that the average urban dweller, in contrast to the peasants, will be less excited about economic reforms. Peasant enthusiasm, which ensured the success of agricultural policy changes, was based upon farmers' perception that they could reap immediate gain from the new policies. Urban reform policies, however, are not so clearly advantageous to China's workers. [REDACTED]

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As with agriculture, the urban program aims to raise efficiency by introducing market incentives, employing so-called "economic levers" such as prices, taxes, and interest rates, and by forcing enterprises to compete. The average man-on-the-street appreciates the promised fruits of economic reforms: more variety and greater availability of foodstuffs, growing supplies of stylish clothing, better quality bicycles, color television sets, washing machines, and heretofore unavailable consumer durables, expanded free markets, and improved services. But the reforms also mean that the average worker faces potentially serious dislocations--in his workplace, home, and the market. [REDACTED]

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In the Factories--Concern over Possible Changes

Three decades of Maoist industrial and labor policies have not only institutionalized the inefficiencies typically associated with Soviet-style centrally planned economies, but in our view also eroded the traditional Chinese work ethic. Motivating the urban workforce has always been a key to achieving the economic goals set by the leadership, but prereform policies made the task impossible. China's eight-grade wage structure had not changed significantly since the 1950s; wage differentials were small; bonus payments in most factories were distributed on a nearly egalitarian basis; and very few enterprises succeeded in establishing a direct link between work effort and pay. Moreover, absenteeism was high in most factories and underemployment rampant. Foreign observers who visited Chinese plants invariably noted that there seemed to be twice as many workers as jobs and that many workers did not work very hard, if at all. [REDACTED]

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The Central Committee Decision on urban reform issued last October attacks these problems by linking future worker remuneration to productivity gains. [REDACTED]

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previous experiments with wage and bonus reform did not lead to gains in productivity, in part because they were limited to moderate (10 percent) wage hikes for workers at the lower end of the wage scale, and avoided structural wage reform. [REDACTED]

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For the average Chinese worker, wage reform will mean working harder for a wage that may rise or fall depending on the profitability of his work unit, as well as the loss of "free" bonus payments. Bonuses were originally intended as a managerial tool to stimulate productivity, but largely because of the Maoist legacy of egalitarianism, bonus payments became an automatic and expected source of additional income. Factory managers began paying bonuses not to reward increased productivity, but to guarantee that workers put in at least a minimum work effort. By the early 1980s, practically all of China's factories were distributing bonus payments on a near egalitarian basis and more often than not, the growth rate of bonus payments far exceeded the growth rates for either productivity or output.

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In short, wage reform will create a more unstable environment for the average worker. If successfully implemented, noncompetitive enterprises will close and their workers will have to find new jobs. Skill levels and education are to be more important for advancement than political ties or seniority. Wage reform probably will also lead to the development of greater wage differentials and to income inequality in the cities--changes that most Chinese workers certainly are not used to, may not understand, and may well oppose.

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Chinese worker apprehensions about what urban reform may bring are not unreasonable and are illustrated by the case of a celebrated reform-minded factory manager named Bu Xinsheng. This Zhejiang province shirtmaker became nationally renowned during 1984 as a competitive, profit-conscious urban reformer who boldly instituted wage, bonus, and other reforms that resulted in sharp gains for his factory. Bu quickly became a national model and his factory was front-page news in national newspapers. According to foreign visitors to Bu's factory, however, the shirtmaker's reformed operation more closely resembled a 19th century sweatshop than a reform-oriented model socialist enterprise.

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Bu's wage reform measures were strict. He paid workers low basic wages with steep piece-work targets for bonuses. In addition, Bu cracked down on absenteeism and cut welfare costs by making workers pay for sick leave taken beyond a couple days per year. If a worker could not measure up to Bu's demanding standards, the worker was fired, losing not only his wages, but also his housing and his unit ID card.

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These reforms earned increased profits and raised the factory's productivity, while lowering costs. They also brought controversy and criticism.

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At Home: Fears of Rising Prices, Loss of Subsidies

The urban reforms have sparked fears of inflation among Chinese city dwellers. Urban consumers in some areas of China rushed out immediately after the program was announced to buy extra food and clothing. Such panic buying of consumer goods has occurred several times in the past five or six years, fueled by expectations of imminent price hikes and rumors of impending wage increases. Inflationary expectations have caused Beijing to go slow on wage reform and, more important, on price reform. [REDACTED]

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Beijing's recent decision to reduce the scope of government procurement of agricultural goods and to permit the prices of certain nonstaple foodstuffs to float freely in urban markets means Chinese consumers will face fluctuations of retail prices. Chinese economic policymakers and academic economists alike have openly predicted short-run price hikes until the market responds and supplies increase sufficiently to reduce prices again. Officials believe they can avoid serious or protracted inflation if they cautiously implement price reform and restrict growth of the money supply. [REDACTED]

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Convincing the man-on-the-street, however, will be difficult, especially for a government that for three decades has proclaimed price stability as one of its greatest achievements. Urban residents--especially those over the age of 50--vividly remember the hyperinflation of the late 1940s, which helped bring down the Nationalist government, and they may find unconvincing government assurances that real incomes will not diminish as a result of the new policies. [REDACTED]

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The reforms also directly threaten the elaborate system of subsidies, or as the Chinese call it, the "iron rice bowl," that urban workers have come to depend on. Subsidies in China's cities are all-pervasive. From the time the urban residents wake up in the morning (boiling subsidized noodles using subsidized fuel) until they go to bed at night (in rent-subsidized apartments), Chinese workers lead the ultimate--next to cadres--in sheltered living, and not surprisingly have developed a welfare mentality. [REDACTED]

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The typical Chinese factory provides subsidized housing, child care, cinemas, schools, medical facilities, and low-cost meals in dining halls. Visiting a state-owned enterprise is like entering a self-sufficient city within a city. The reform-minded Chinese leadership refers pejoratively to factories that strive for such self-sufficiency as "large and complete" or "small and complete," and evidently has hopes of streamlining them in the name of improving efficiency through greater specialization. Factory managers, however, have long used fringe benefits and subsidies as work incentives. Subsidies, like bonus payments, theoretically stimulate output or raise productivity--though in most cases they merely maintain current work levels or prevent productivity from falling. [REDACTED]

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Previous industrial economic reforms, moreover, have tended to add to the problem. Since Beijing granted factory managers greater autonomy and the right to retain a portion of the enterprise's profits--major features of the urban reform program--factory managers have used a considerable portion of retained profits to build new housing for employees, to expand dining facilities, and to increase the size of bonus payments to workers--rather than using the funds on reinvestment to expand the factory's capital stock.

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Some western economists estimate that subsidies to urban residents in China reach or exceed slightly their average annual money incomes. According to the Chinese press, per capita subsidies to residents of Beijing during 1983 totalled 168 yuan (US\$84.80)--equivalent to more than one fourth of average per capita incomes in China's capital. Although the Chinese government does not release statistics on urban subsidies, the available data on urban consumption patterns illustrate the degree to which the typical man-on-the-street is insulated from the true cost of living. Chinese urbanites during 1983, for example, paid only 0.64 yuan (\$0.32) per month for rent, and 0.48 yuan (\$0.24) per month for utilities. This total for rent and utilities--\$0.60 or 2.7 percent of average monthly expenditures--is far below that of comparable less-developed countries. Under the reforms, workers will have to assume more of the actual costs of their day-to-day life.

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Winning Acceptance

To the Chinese man-on-the-street, urban reforms are a mixed blessing. Increased efficiency may bring faster economic growth, more and better consumer goods, improved living standards, and higher wages and bonuses. On the other hand, urban reforms create an atmosphere of considerable uncertainty. Beijing is aware of these concerns, and although committed to moving forward with reform, also seems intent on cushioning the impact of new policies on the average Chinese.

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We expect the Chinese leadership will continue to move cautiously but steadily, maintaining as much control as possible over price increases, job layoffs, and wage and bonus payments. We anticipate that there will be some wage adjustments for urban workers approved before the full effect of price reform is felt in the cities. The government's principal task may be to control the size of the increases and prevent overpayments. We believe the politically conservative government, when forced to choose, will sacrifice the achievement of productivity gains to avoid worker discontent. As far as consumer prices are concerned, the government seems to be banking on a rapid supply response to price adjustments, which will tend to shorten the dislocation period. The government expects that consumer goods prices probably will rise in the short term, but will stabilize or even fall as greater supplies hit the marketplaces. Rent, fuel, and transportation costs will rise more slowly, and wage gains will tend to offset these costs.

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How successful Beijing's policies are will be in part a function of the average Chinese worker energetically embracing them and making them work. This, in essence, was the source for success of agricultural reform. The task is much more complex in the cities, however. We believe two factors will shape the man-on-the-street's attitude toward urban reforms: he must see some immediate benefits to offset the real and psychological costs of compliance; and he must believe the leadership is united and determined to press forward with policy change. In our view, neither of those conditions is now present. The leadership appears divided over some of the reform policies, and clear guidelines on implementation evidently have not been sent out. In the absence of clear directives, local governments are moving slowly on urban reform policies, and there seems to be a good deal of uncertainty and many rumors about what is actually being planned. Until this situation is resolved, we expect that urban workers will maintain a "wait-and-see" attitude toward the regime's efforts to promote the new reforms.

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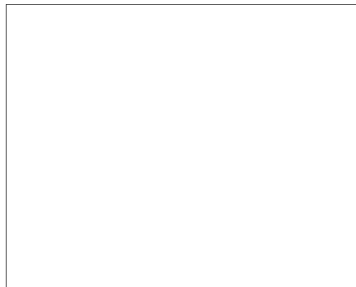
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