

## PLANNING AND THE MARKET IN CHINA

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### INTRODUCTION

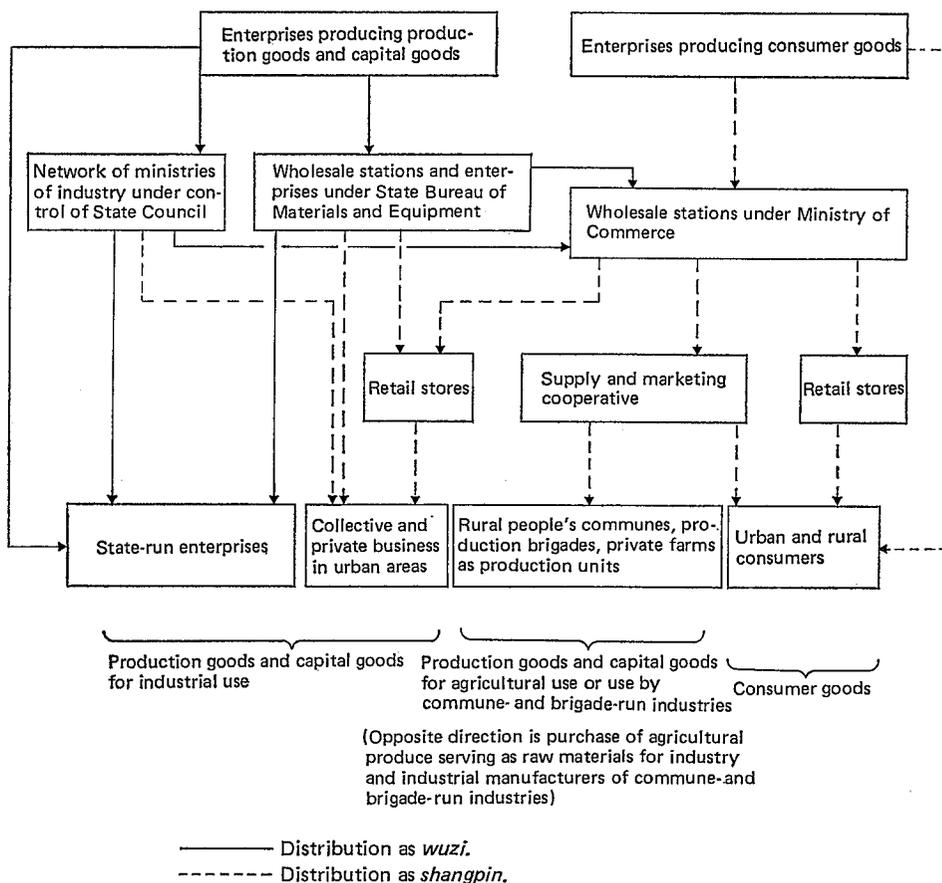
PAST planning management in the People's Republic of China has been through classification of production into *wuzi* (materials and equipment) and *shangpin* (commodities). The control has been enforced less through guidance by economic regulators such as prices and more through the direct means of mandatory plans. On the other hand, what we may call the basis of centralized planning management, the share in total production of *wuzi* under the unified distribution system of the central government, has declined a considerable amount in the 1970s. The position held by administrative mandatory plans in the economy has de facto fallen. This is one of the factors behind the enlargement of the decision-making powers of enterprises, the introduction of elements of the market mechanism, and other facets of the economic reforms since the end of the 1970s. The model of reform which the Chinese aim at must reflect this state of affairs.

### I. DECLINE IN ROLE OF CENTRAL PLANNING

#### A. *Wuzi and Shangpin*

When taking up the issue of planning and the market in China, note must be made that the methods of planning management may be classified into two groups according to the types of the goods. Specifically, they may be classified according to whether the products are "materials and equipment" or "commodities." The first of the two constitute the production and capital goods distributed among state-run enterprises and are known as *wuzi*.<sup>1</sup> As opposed to this, the commodities sold between state-run enterprises and collectively owned enterprises (including people's communes and production brigades), among collectively owned enterprises, and between state-run enterprises and private individuals are known as *shangpin*. This relation is illustrated in Figure 1. *Shangpin* primarily include consumer goods, agricultural produce, and agricultural production goods. The

<sup>1</sup> This system started in the Soviet Union. The theory behind it is the Stalinist theory that means of production circulating among state-run enterprises are not commodities. In present-day Chinese theoretical understanding, *wuzi* materials and equipment are also *shangpin* commodities (Sun Shanging et al., "Shiping woguo jingji xuejie 30 nianlai guanyu shehuizhuyi shangpin, jiazhi wenti de taolun" [An appraisal of the discussions on socialist commodities and prices by China's economic circles in the past thirty years], *Jingji yanjiu*, 1979, No. 10, pp. 10-11. However, in practice, the term *wuzi* is still used.

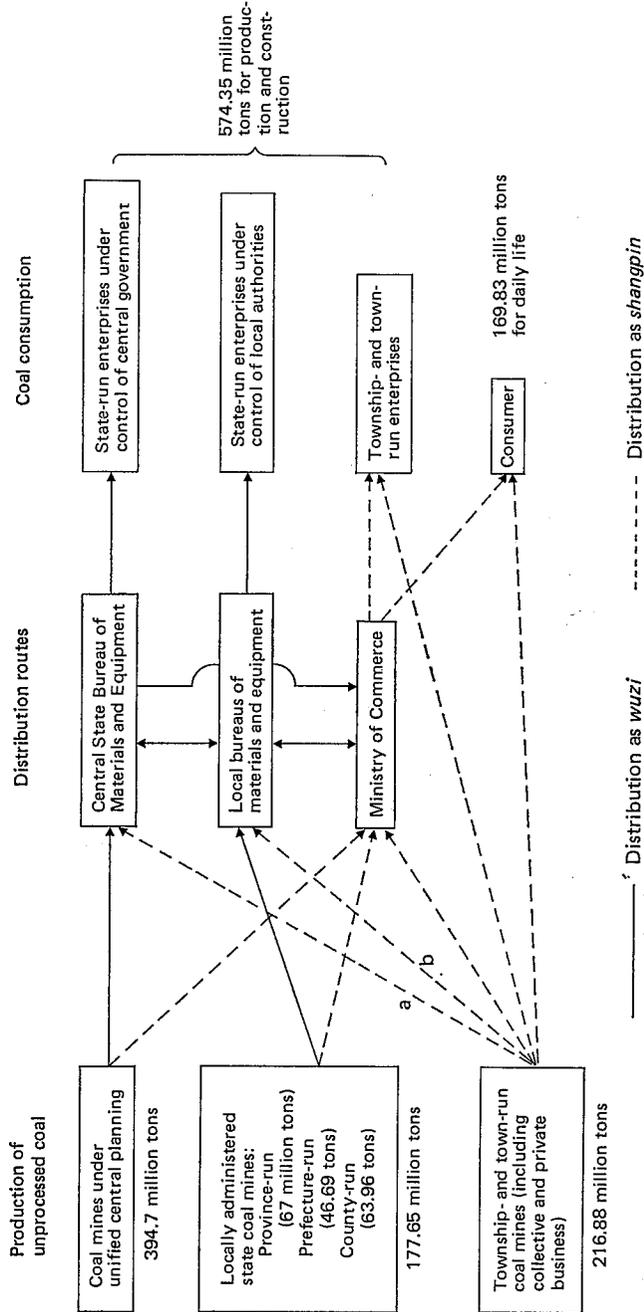
Fig. 1. Distribution Routes of *Wuzi* and *Shangpin*

Source: Based on Huang Xuezhong and Deng Zhiyang, *Gongye qiye shichang yuce* [The market forecasting for industrial enterprises] (Beijing: China Financial and Economical Publishing House, 1983).

classification is based on the criteria of which government organization or administrative unit handles the goods in the distribution process. The classification is also closely related to planning management in the production process.

The same item may be treated both as a *shangpin* and a *wuzi* in some cases. Take for example coal. Its process of distribution from the production to consumption stage is shown in Figure 2. Almost all of the unprocessed coal produced by the coal mines under unified central planning is distributed as production goods (*wuzi*) under the central government distribution system. At the same time, the majority of the unprocessed coal produced by enterprises run by townships and towns is sold as *shangpin* for general daily consumption and use by township and town enterprises.

Fig. 2. Distribution of Coal, 1984



Source: *Zhongguo meitan gongye nianjian, 1985* [The yearbook of China's coal industry, 1985] (Beijing: China Coal Industry Publishing House, 1985).

Note: The distribution from the township- and town-run mines to the bureaus of materials and equipment of the central government and the local governments (provincial, prefectural, and county) is through a new route opened by the economic reforms instituted since the end of the 1970s.

a 6 million tons.

b 50 million tons to provinces and 30 million tons to prefectures and counties.

### B. *Management of Distribution of Wuzi*

Looking in more detail at the aforementioned *wuzi* materials and equipment from the aspect of planning management, the *wuzi* are further classified into the following three groups [21, pp. 26–46] [8, pp. 512, 539]. This classification was established in the 1950s and was used to regulate the distribution of materials and equipment for a long period until the introduction of the new classification in 1980.

(1) *Yilei wuzi* (materials and equipment under category I) or *tongyi fenpei wuzi* (materials and equipment under unified central planning): Under the supervision of the State Planning Commission, the State Bureau of Materials and Equipment prepares balance charts and distribution plans for key goods. The *wuzi* which fall under this particular category include coal, pig iron, steel materials, copper, aluminum, lead, zinc, tin, copper materials, aluminum materials, lead materials, sulfuric acid, concentrated nitric acid, caustic soda, refined soda, cement, lumber, automobiles, heavy oil, rubber, power machines, and metalworking machines.

(2) *Erlei wuzi* (materials and equipment under category II) or *zhongyang ge gongyebu fenpei wuzi* (materials and equipment under distribution by the ministries of industry of the central government): These are goods which are distributed by the government organizations concerned with industrial matters under the State Council. The specialized production and capital goods which one ministry would primarily use fall under this category and include, for example, mineral ores, oil boring machines, the spinning machines and specialized spinning equipment distributed under the Ministry of Textile Industry, and the ferrous alloys and coke distributed under the Ministry of Metallurgical Industry.

Also included are production goods and capital goods of relatively high importance which are used in common by the various ministries, for example, newsprint, trucks, and chemical and industrial fuels.

(3) *Sanlei wuzi* (materials and equipment under category III) or *difang guanli wuzi* (materials and equipment managed locally): These are goods which are managed by the material and equipment sectors of the provinces (and municipalities directly under the central authority and autonomous regions), special administrative districts or prefectures (or provincially administered cities), and counties on their respective levels. There are over 10,000 such goods. The following may be given by way of illustration: metal utensils handled by the five metals corporation; vehicles parts and electrical equipment of the traffic and electric goods corporation; the production goods handled by the chemical industry materials corporation; the tung oil, hemp rope, bamboo and wood products, jute rope, and bamboo materials handled by the native produce corporation; and the gasoline, diesel oil, lubricating oil, worker safety equipment, measuring equipment for chemical tests, and reagents for chemical tests handled by the commercial sectors. Also included are items which are diverse in nature and feature regional differences in production and consumption, making them unsuitable for unified national distribution, such as bricks, tiles, sand, and stone.

Among these items classified as *wuzi*, the important materials and equipment produced by the state-run enterprises are incorporated into the state plans over

the entire process from production to purchasing, supply, and consumption. This is the first difference from distribution of *shangpin*. *Wuzi* bear prices fixed by the government and therefore, of course, do not enjoy the barometer function of prices (wherein prices fluctuate in reflection of the supply and demand situation in the market). Further, the parameter function of prices (wherein the supply and demand is adjusted in accordance with the changing market prices) does not substantially work. In particular, under the system prior to 1978, the production items of *wuzi*, their production volumes, and even the raw materials, fuel, and equipment used for that production were set down in the plans, so enterprises had very little discretion when it came to deciding upon production volumes to match prices of individual items.

In particular, materials and equipment under category I were centrally managed by the State Bureau of Materials and Equipment under distribution plans. Further, the items classified therein were mostly important production goods and capital goods which served as the foundation of the national economy. The uniform distribution of materials and equipment under category I, one may say, enabled the centralized planning by the central government.

Figure 3 shows the percentage of key materials and equipment under category I controlled under the uniform distribution system. For the percentages of unified distribution of coal, steel materials, cement, and lumber in the total production, comparison is possible between the 1960s and the 1980s. The absolute amount of uniform distribution has increased, but the percentage with respect to total production has fallen. The range of sectors which can no longer be controlled by the centralized distribution of the central government has expanded.

In this way, for much of the materials and equipment which are subject to unified distribution, the percentage of actual distribution by the central government has fallen. The following may be mentioned as reasons for this [13, pp. 16-17].

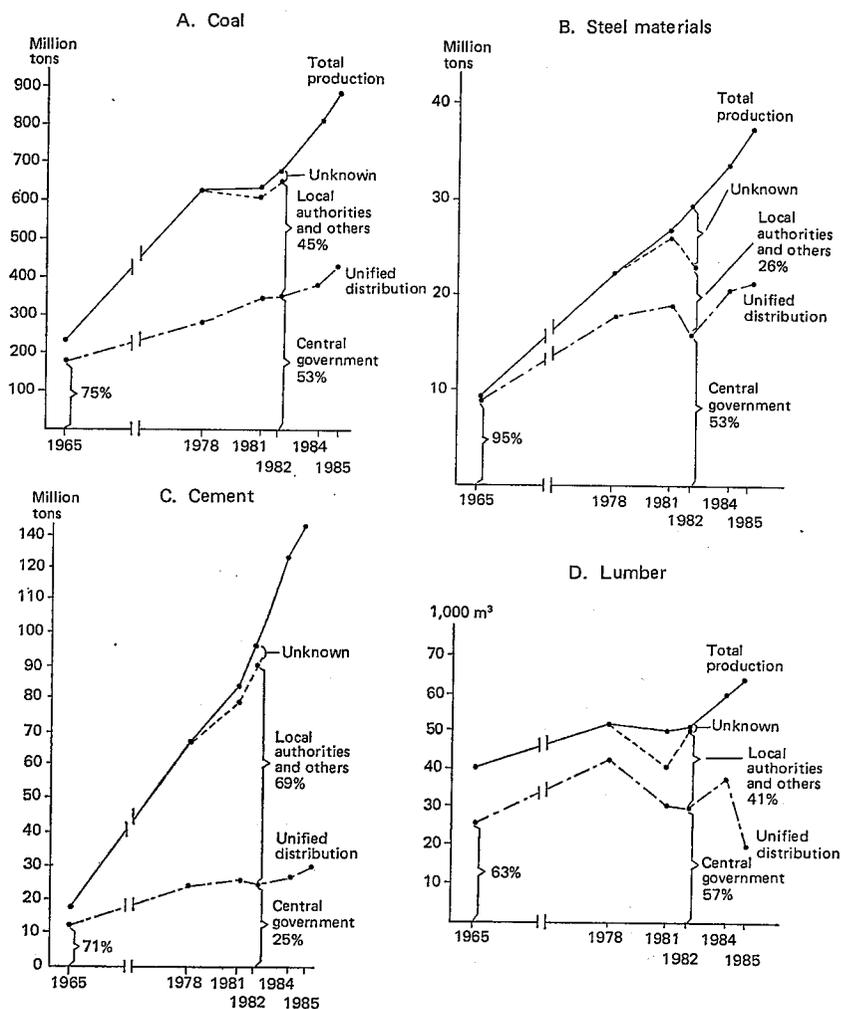
First, the amount of production goods and capital goods held by the local regions has increased. This is due in part to the transfer in 1958 and 1970 of enterprises under the jurisdiction of the central government to the jurisdiction of the local authorities. Further, production of steel materials, cement, coal, and the like by small-sized enterprises controlled by the local authorities and others has increased considerably. For example, production by key cement factories in the unified distribution system rose only 2.8-fold from 1958 to 1982, while production of local cement factories rose as much as 257-fold in the same period. The production of key coal mines rose only 2.2-fold from 1963 to 1980, while production of local coal mines rose 5.7-fold.

The production goods and capital goods supplied under the Shanghai Bureau of Materials and Equipment are subject to regulations comprised basically of the following four points [22, p. 235].

(a) Supply is only possible within the city; supply outside the city is not permitted.

(b) Supply is only possible in accordance within the industrial sectors controlled by the respective supervisory organizations; supply across sectorial lines is not permitted.

Fig. 3. Percentage of Unified Distribution by Central Government



Sources: Total production: [18, 1985 edition]; for coal 1985, [9, April 6, 1986]. Percentage distribution: 1965—[13, p. 16]; 1978 and 1984—T. Yamagishi and K. Ii, trans., *Chūgoku shakaishugi busshi kanri taisei shiryaku* [A historical sketch on materials management system under Chinese socialism] (Tokyo: Japan External Trade Organization, 1986), p. 90; 1981—China Research Society of Industrial and Economic Management, *Zhongguo gongye jingji guanli (xia)* [China's industrial and economic management (the last volume)] (Beijing: China Social Sciences Publishing House), p. 279; 1982—Chen Xian, *Guomin jingji he shehui fazhan jihua mingci jieshi* [The dictionary of national economy and social development plan] (Beijing: Institute of Planned Economy, State Planning Commission, 1984), p. 205, and Zhou Taihe, et al. *Dandai Zhongguo de jingji tizhi gaige* [Economic reforms in present China] (Beijing: China Social Sciences Publishing House, 1984), p. 516; 1985—[26, p. 13], for coal, [9, April 6, 1986].

(c) Supply of materials and equipment under category I and category II to other provinces (cities) is not permitted. Supply of materials and equipment under category III to the outside of Shanghai is allowed, but letters of introduction are required.

(d) Supply is only possible to state-run enterprises; supply to collectively owned enterprises is not permitted.

Regulation (d), in particular, is out of line with reality. According to the regulation, the Bureau of Materials and Equipment cannot supply production goods and capital goods to the rural commune- and brigade-run enterprises (*shedui qiye*) or urban collectively owned enterprises, which have been making great strides since the 1970s. Further, this regulation would conversely make it impossible to incorporate the production of local, small-sized industries into the state plans.

Second, discipline of planning management has become loose. Even if production targets under the plan are exceeded, there are cases where the targets for supply are not met, production concentrates in relatively high priced items, or products are sold to production enterprises or construction units outside of the plan at higher than the plan prices.

Third, we can mention a most fundamental factor proper to centralized planning systems. As pointed out by Ellman, when the central authorities are ignorant to some extent about the overall economic situation and, further, the techniques used for data processing are inadequate, the direct and incomplete centralization is inefficient [2, Chap. 3].

Further, the increase in production volumes and the diversification of production items have resulted in much greater complexity in the economy. At the start of the 1950s, when controls over materials and equipment began, there were only eight types of *wuzi*: steel materials, lumber, coal, cement, refined soda, copper, machine tools, and hemp bags. Later, the number of items gradually increased until by 1981, combining the materials and equipment under the unified distribution system and the materials and equipment distributed by the ministries of industry, they reached 837 items. By way of note, comparing the classification with the Commodity Indexes for the Standard International Trade Classification, lumber, coal, and cement fall under the intermediate classification of "Divisions" while steel materials, copper, and other metals fall under the lower level sub-classification of "List of Groups."

### C. *Distribution of Shangpin*

#### 1. *Classification*

*Shangpin*, like the previously mentioned *wuzi*, may be classified into three groups from the differences in management methods. The first such method was set forth in the 1959 *Shangpin fenji guanli banfa* (Rules of classified management of commodities) [1] [25, pp. 160–63]. This covered the following goods:<sup>2</sup>

(1) *Yilei shangpin* (category I commodities): These are commodities which

<sup>2</sup> Xu Dixin et al., ed., *Zhengzhi jingjixue cidian (xia)* [Dictionary of political economy (the last volume)] (Beijing: People's Publishing House, 1980), p. 428. According to the

are controlled by the ministries and commissions of the State Council under the *tonggou tongxiao* system of the state monopoly for purchase and marketing. They include grain, oil-bearing crops, oils and fats, cotton, cotton yarn, cotton fabric, gasoline, diesel oil, lubricating oil, and coal.

(2) *Erlei shangpin* (category II commodities): These are commodities which are controlled by the ministries and commissions of the State Council under the *tonggou* system of purchase under the state monopoly, *paigou* system of purchase by state quotas, and the *baoxiao* system of exclusive sales. They include live swine, fresh eggs, jute and hemp, ramie, silk cocoons, wool, leather, hemp rope, chemical fertilizer, agricultural chemicals, wires, nails, sewing machines, bicycles, some drugs, and materials for herbal medicines.

(3) *Sanlei shangpin* (category III commodities): These are goods for which *yigou yixiao* (negotiated purchase and marketing), *xuangou* (selective purchases), *shengchan danwei zixiao* (sales through a productive establishment's own channels), and other methods of purchase and sales are allowed. They include sundry goods, marine produce and fruit produced in regions other than main production regions (marine produce and fruit of main production regions would fall under category II), and herbal medicine materials which are collected from widespread areas and whose yield is small.

According to the 1959 classification of commodities, there were 38 category I commodities and 293 category II commodities. Subsequent revisions to the classification have reduced the numbers significantly. Among the category I commodities, grain, edible oil, cotton, cotton yarn, and cotton fabric are controlled by the State Council as to purchasing, sales, transportation to and from provinces, import and export, storage, and other targets. Gasoline, diesel oil, heavy oil, and lubricating oil are controlled by the State Council as to the targets or norm for distribution to economic sectors and import and export. Category II commodities are controlled by the central supervisory ministries of the State Council as to the targets for distribution to different regions and sectors and import and export.

The prices for the purchase and sale of category I commodities under the state monopoly system and the prices for purchases under the state monopoly and purchases by state quotas for category II commodities are planned prices set uniformly by the government. Even some of the category III commodities are controlled by planned prices when they involve sale by the state-run commercial sector.

## 2. *Distribution of industrial goods*

Among industrial goods, consumer and production goods for the agricultural sector are distributed as *shangpin*. A look at the methods by which the commercial

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glossary in the book edited by Lin and Chao, in *wuzi*, category I is explained as including grain, edible oil, cotton, cotton fabric, coal, and the like and category II swine, eggs, sewing machines, bicycles, and the like [Lin Wei and Arnold Chao, ed., *China's Economic Reforms* (Philadelphia: University of Pennsylvania Press, 1982), p. 317]. This completely confuses *wuzi* (materials and equipment) with *shangpin* (commodities).

sector purchased manufactured products from industrial enterprises shows the following two methods used in the 1960s and 1970s.

(1) *Tonggou* (purchasing under the state monopoly system)—category I commodities were purchased in the prescribed types and quantities. Mandatory legal sanctions were applied.

(2) *Baoxiao* (exclusive sales)—category II commodities and some category III commodities were subject to exclusive purchasing and exclusive sales. Industrial enterprises were not able to sell products on their own. The difference with the *tonggou* purchases under the state monopoly was that no mandatory legal sanctions were involved.

In the 1950s, there were also the *jiagong* and *dinghuo* (placing of state orders with private enterprises for processing of materials or the manufacture of goods), but these systems disappeared with the conversion to joint private-state ownership in 1956.

New purchasing systems began to be introduced in 1980, followed by considerable diversification of purchasing methods in later years. As of the present moment, there are four main systems [15] [5, p. 289].

(1) *Tonggou tongxiao* (purchases and sales under the state monopoly system)—The industrial sector is not allowed to sell its own products, not only that portion of production targeted under the plans, but also the portion of production over and above the plans. Covered under this are eleven commodities, including cotton yarn, cotton fabric, and oil.

(2) *Jihua shougou* (planned state purchases)—Industrial enterprises are allowed to independently sell portions of production over the plan targets. The commercial sector is allowed to engage in negotiated purchases. Covered under this are twenty-four commodities, including sugar, cigarettes, chemical fibers, wool woven fabrics, silk woven fabrics, towels, wool yarn, rubber shoes, matches, soap, pencils, watches, and bicycles.

(3) *Dinggou* (purchases by order)—Purchasing contracts are concluded by negotiation between the production enterprise and the distribution enterprise. Covered under this are eighteen commodities including powdered milk, brandname wines and liquors, sewing needles, spirits, wines, fabric shoes, aluminum pots, and television receivers.

(4) *Xuangou* (selective purchases)—These are for category III commodities for which there are no unified standards. Purchases are made from industrial enterprises in consideration of market supply and demand.

### 3. *Purchasing methods and prices for agricultural produce*

#### (a) Three purchasing methods

The purchasing methods for agricultural produce are determined according to which of the category I, category II, or category III classifications of commodities the produce falls under. At the present time, there may be several different purchasing methods employed for the same agricultural produce. However, in principle the methods established in the 1950s are still being used. These may be classified into the following:

(1) *Tonggou* (purchases under the state monopoly system)—category I agri-

cultural produce: In the purchasing system under the state monopoly, production teams or farmers of the rural people's communes must sell their produce, except portions allowed to be retained by the government (in the case of grain, rice for home consumption, seeds, feed, and grain for stockpiling) and portions used for paying agricultural taxes, to the state designated commercial sector at unified purchasing prices set by the state. Private merchants are banned from purchasing from the farmers and thus the state commercial sector enjoys a monopoly. The produce belonging to the category I commodities are covered by this state monopoly system. Grain and oil-bearing crops were placed under this system from November 1953 and cotton from September 1954. Lumber was reclassified as category I agricultural produce as of March 1981.

(2) *Paigou* (purchase by state quotas)—category II agricultural produce: This system was first applied in 1955 to the purchases of swine. It was expanded to cover other products in subsequent years (particularly in 1959). At the present time, the cattle and sheep of livestock raising regions, tobacco, hemp, silk cocoons, tea, lacquer, tung oil, and other category II commodities are covered. The state designated commercial sectors use administrative means to allocate supplies of these agricultural produce to the people's communes and production teams.

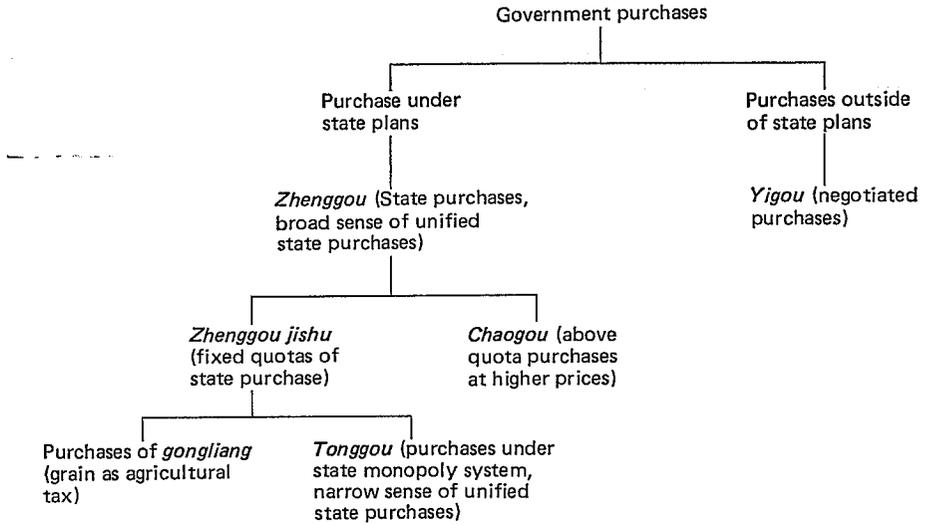
(3) *Yigou* (negotiated purchases)—category III agricultural produce: The state does not set any duty of supply on producers of these goods. Transactions are established by negotiation between the commercial sector and the producers. Goods falling under this category include regional specialities, sideline products for daily use, some fruits and dried vegetables, seasoning, wild fibers, miscellaneous oil-bearing materials, medicinal materials, and other category III commodities [4, pp. 112–13].

The above purchasing methods have been used to adjust controls on purchasing amounts and prices according to the importance of the agricultural produce to the national economy. For the extremely important category I grain, oil-bearing crops, and cotton, the state has exercised a monopoly over the distribution process. The purchase sum of these three commodities accounts for 45 per cent of the value of total purchases of agricultural and sideline produce by the state-run commercial sector [27, p. 289].

(b) Purchasing methods of grain

For a closer look at what kind of effect prices have on agricultural production in China, we will take up the purchasing method and prices for grain. Grain belongs to the category I agricultural produce. As mentioned above, in 1950s, grain was subject completely to *tonggou* system of purchases under the state monopoly system. In subsequent years, various other methods became allowed, such as the *chaogou* system of higher price purchases for production beyond state quotas (in some regions, including a *zenggou* system of additional purchases for production beyond state quotas, a *chaochaogou*, *chaochaochaogou*, and other additional purchase systems) and *yigou* system of negotiated purchases (see Figure 4). Differences in purchasing prices appeared depending on whether the grain was purchased by the *zhenggou jishu* (fixed quotas of state grain purchases), the *chaogou*, or the *yigou*.

Fig. 4. Methods of Government Purchasing of Grain



Source: Prepared by author.

The purchasing prices for the *zhenggou jishu* have been raised by wide margins three times up until now: 25 per cent in 1961, 17 per cent in 1966, and 20 per cent in 1979.

Under the *chaogou* system, after the *zhenggou jishu* have been met, grain is purchased at higher prices. The amount of the purchases, unlike with the *zhenggou jishu*, is determined each year in consideration of the harvests (*yinian yiding*). These above quota purchases include a fixed premium over the *zhenggou jishu* purchasing price (*pingjia*). The amount of the premium has been gradually raised from 10 per cent with respect to the *pingjia* in 1960 and 1961, to 12 per cent in 1965, 30 per cent from 1971 to 1978, and 50 per cent since 1979.<sup>3</sup>

The *zhenggou jishu* purchases and above quota purchases are made under state plans and so are both included in the *zhenggou* state grain purchases in the broad sense of the term. The government also makes purchases through negotiations with the farmers. Among the *zhenggou jishu* purchases, the above quota higher priced purchases, and the negotiated purchases, the lower the amount of the low priced *zhenggou jishu* purchases, the better for the farmers. Therefore,

<sup>3</sup> Bruce Stone makes clear that the surplus quota price of agricultural produce contributed to the expansion of fertilizer use despite the "punitive" fertilizer to farm-goods-price ratios [Bruce Stone, "Chinese Fertilizer Application in the 1980s and 1990s: Issues of Growth, Balance, Allocation, Efficiency and Response," in *Chinese Economy Looks toward the Year 2000*, Vol. 1, *The Four Modernization*, ed. U.S. Congress Joint Economic Committee (Washington, D.C.: U.S. Government Printing Office, 1986), p. 489]. Invoking N. Lardy's paper [12], Bruce also explains that the surplus quota price system was established in 1970. But the latter half of his point is mistaken. As mentioned in the text, the first establishment of this price system was in 1960 [24, p. 163].

TABLE I  
PERCENT COMPOSITION OF PURCHASED GRAIN CLASSIFIED BY  
PURCHASING METHODS

	1978	1979	1980-84	1985	1986	1987
State monopoly purchases	68.5	49.5	32.0			
Above quota purchases at higher prices	28.9	42.2	32.2			
Purchases by order				64.0	48.0	40.0
Negotiated purchases	2.6	8.3	36.0	36.0	52.0	60.0

Source: [26, pp. 19-21].

Note: The average annual purchases from 1980 to 1984 and the annual purchases for the years 1985 to 1987 are assumed as 125 million tons.

the rate of achievement of the *zhenggou jishu* quotas is not very good. The absolute volume of grain purchased under the *zhenggou jishu* quotas fell from 70 billion catties in 1979 to 68.7 billion catties in 1980 and 60.8 billion catties in 1981. Despite this, the rate of achievement fell from 90 per cent to 81 per cent and 80 per cent.

As clear from Table I, the percentages of the above quota purchasing prices and negotiated purchasing prices in total purchases have risen each year. The percentage of the portion of production which the government can lay its hands on by administrative command, i.e., the *zhenggou jishu* quotas, has fallen and the portion which must be procured through raising purchasing prices has increased. This shows that the old policy of securing commodity crops by administrative fiat had reached a dead end. Finally, in 1985, the government scrapped the system of compulsory procurement and moved to a system of purchases by order. For the government to secure the same amounts of grain it had in the past, in the future it will have to increase the amount of its negotiated purchases.

As mentioned above, purchases of agricultural produce in China, especially purchases of grain, have been less guided by prices and more for the administrative control of production. This is not meant as a criticism of past agricultural policies of China. Indeed, as clear from many Chinese editorials since the end of the 1970s, one cannot say that prices have been determined in accordance with changes in costs. There is no denying the fact that China gave priority to price stabilization and to closing income disparity, which resulted in the detriment of efficient allocation of resources [12, p. 3].

Even before the late 1970s' hikes in government purchasing prices of agricultural produce, there were periods when the Chinese have emphasized guidance through prices or indirect planning. These were the late 1950s and early 1960s economic readjustment periods. However, these policies were not maintained for long. One of the reasons for this was the lack of leeway in the Chinese economy for allocation of resources through the price mechanism. When one considers the gap in per farmer grain production in the 1950s from 245 kg (Hebei Province) to

905 kg (Heilongjiang Province), the chronic shortages, and the supplies required for the burgeoning urban population, the tough administrative controls clamped on agricultural production were only natural [20, p. 165].

Along with the hikes in the government purchasing prices of agricultural produce since 1979, the government has found itself faced with soaring price subsidies, which have reached around 20 per cent of fiscal expenditures. Total price subsidies rose from Rmb 9.4 billion in 1978 to Rmb 37.0 billion in 1984. Looking at agricultural produce, the subsidies rose from the Rmb 100 million in 1957, Rmb 2 billion in 1965, and Rmb 5 billion in 1978 to Rmb 20 billion in 1983 [24, pp. 132–33]. Of this, over half went for grain and edible oil. The bill for past price policies has been paid out in the form of price subsidies.

## II. MISHMASH OF PLANNING AND THE MARKET

### A. *Model of Reform Targeted*

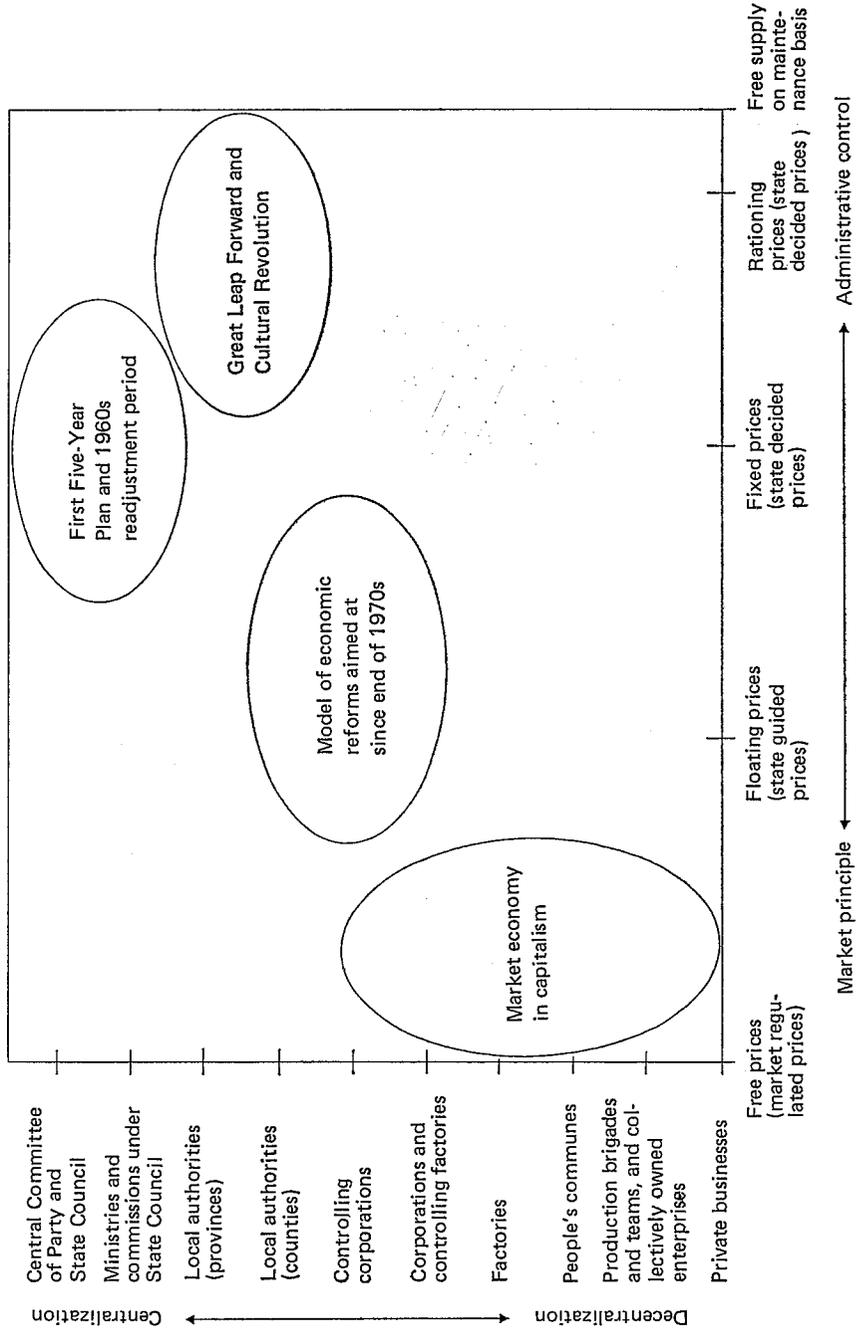
The reforms in the economic system carried out by the Chinese since the end of the 1970s can, the author believes, be organized along two axes. One is the decentralization of power to the local authorities and enterprises. Of particular importance was the enlargement of the decision-making powers of enterprises. In the area of formation of enterprise capital, China has gone through several stages such as institution of an enterprise fund system, profit retention system, and corporate income tax system. The basic direction of all this is toward ensurement of funds for free use by enterprises in accordance with their individual performance.

The other axis of the reforms in the economic system may be said to be the introduction of the market mechanism. In the previous economic system, mandatory plan targets were used for the administrative allocation of resources. The introduction of the market mechanism reduces such mandatory plan targets and simultaneously aims at the allocation of resources through utilization of prices, interest, taxes, and other economic regulators.

Of course, these two "axes" are not necessarily separate. Realization of enlarged decision-making powers in management of enterprises cannot be split from the introduction of the market mechanism. As to why then it is important to differentiate these two axes, the answer is that it is convenient for explaining the transition of China's economic system. China's old economic system seesawed between periods of centralized control by the central government, such as during the First Five-Year Plan and the readjustment periods, and periods of decentralization to the local authorities, such as during the Great Leap Forward and the Cultural Revolution. In both periods, however, the economy was managed through administrative means and thus they may be said to have been the same in this regard. The present economic reforms differ in aim from the two, however, in that they call for decentralization to the enterprises and management by economic means.

Further, organization of the reforms by these two axes is effective in terms of the individual aspects of the reforms of the economic system. For example,

Fig. 5. Two Axes of Price Determination



Source: Prepared by author.

TABLE II  
CLASSIFICATION OF PRICE CONTROL SYSTEMS

Price Control Systems	Final Authority over Prices	Movement of Prices	Degree of Involvement of Plans
Price decided by state	Administrative organization having jurisdiction	Fixed prices	Administrative commands, Planned prices
Price guided by state	Business units, controlled	Floating prices	Administrative guidance, Planned prices (Negotiated prices)
Price regulated through market	Business units, uncontrolled	Free market prices	Arrangement between enterprises, Unplanned prices (Negotiated prices) Competitive prices, Unplanned prices

Source: Yang Lu, "Guojia zhidao jiage yingshi zhuyao jiage xingshi" [Prices decided by state must constitute the leading price system], *Jiage lilun yu shijian*, 1986, No. 6, p. 3.

the reforms of the pricing system are differentiated by which level the authority for pricing and control lies in. The vertical axis in Figure 5 from control by the central government to management by individuals corresponds to the change from centralization to decentralization. The horizontal axis shows the change from management of the economy by administrative means to the market principle. As the most administrative-like means of control, there are, of course, price determination and also the rationing system, which limited even sales amounts. Stretching to the other end of the spectrum, free pricing, lie various other forms of price controls. The present stage of economic reforms are aimed at the decentralization of authority to the enterprises and the introduction of the market principle. Leaving aside the question of how much progress China has actually made in this respect, the targeted model may be positioned near the center of Figure 5.

Details of the state decided prices, state guided prices, and market regulated prices shown in Figure 5 are set forth in Table II. The state guided prices form the nexus of the present model of economic reforms. For the goods covered by the state guided prices, while there are various regulations on pricing, the final decision on the prices is left to the production units and the business units. Among these regulations are the following cases: "floating prices" for which upper limits, lower limits, or upper and lower limits are set; "negotiated prices of production areas" which are determined through negotiation among related parties in industry, commerce, trade, agriculture, etc. organized by the authorities in the production areas in charge of supervising commodity prices and the authorities in charge of supervising administration of the industrial and commercial sectors; "negotiated prices of neighboring areas" which are determined by the

related government authorities and enterprises in neighboring regions; "unified prices of industry" which are determined through negotiations among the production and business units in the industry and submitted for approval by the government authorities in charge of supervising commodity prices, etc. The state decided prices, through the administrative master-servant relationship between the supervisory organization and the enterprise, have the mandatory force of law, while the state guided prices are semi-mandatory and semi-free for negotiation by nature.

Note that same "negotiated price" (*yijia*) may sometimes be considered a state guided price and may sometimes be considered a market regulated price. For the above-mentioned "negotiated prices of production areas," "negotiated prices of neighboring areas," and "unified prices of industry," the supervisory organizations participate in the negotiations, so these belong in the area of state guided prices. On the other hand, the prices determined by production units and business units through negotiations on their own or the negotiated prices within an industry, which do not require the approval of the authorities in charge of supervising commodity prices, fall under market controlled prices.

#### B. *Progress in Conversion to Commodity Economy and Market Economy*

##### 1. *"Decision on reform of the economic structure"*

The "Decision of the CCP Central Committee on reform of the economic structure," adopted at the Third Plenary Session of the 12th Central Committee of the Chinese Communist Party held in October 1984, summarized the basic feature of the state planning system aimed at by China as "a planned commodity economy under public ownership." Of note here was that the party and the government officially defined socialism as a "commodity economy." This was a tremendous reversal of China's past interpretation of socialist theory.

In the debate over state planning and the market which has gone on since 1978, much had already been spoken about the necessity of utilization of the functions fulfilled by commodities and currency in socialism, but never had socialism been defined as a "commodity economy." Based on classical Marxist critical study, open discussion was made of the inseparability of Chinese socialism and a commodity economy. This happened in an article by then director of the Chinese Academy of Social Sciences, Ma Hong, released in two parts about a month after the third plenary session.<sup>4</sup> The two concepts of "socialism" and a "commodity economy," which seemingly could not be linked in traditional, classical socialist theory, were treated as inseparable in Ma Hong's paper.

Note that the author has no intention of entering into the long years of debate over the relation between socialism and commodities and arguing the propriety of the Chinese interpretation. He merely wishes to point out the changes in the Chinese interpretation.

The theoretical definition of a "planned commodity economy under public ownership" reflects the two directions of changes which are actually occurring

<sup>4</sup> See Ma Hong's paper, *Jingji ribao*, November 19, 1984; *ibid.*, November 21, 1984.

TABLE III  
 PERCENTAGES OF SELF-SUPPLY AND PURCHASES OF COMMODITIES IN EXPENDITURES  
 FOR DAILY LIFE AND EXPENDITURES FOR PRODUCTION

	1978			1983		
	Total (Rmb)	Commo- dities (%)	Self- supply (%)	Total (Rmb)	Commo- dities (%)	Self- supply (%)
Total expenditures for daily life	112.9	39.7	60.3	242.8	58.8	41.2
Food	78.59	24.1	75.9	147.2	40.2	59.8
Clothing	14.74	89.0	11.1	27.7	98.2	1.8
Fuel	8.28	31.9	68.1	13.5	22.4	77.6
Housing	3.67	95.1	4.9	27.6	97.8	2.2
Daily necessities	7.62	87.7	12.3	26.9	99.0	1.0
Total expenditures for production	7.66	45.0	55.0	43.5	73.5	26.5

Source: State Statistical Bureau, Agricultural Statistical Department, ed., *Woguo nonmin shenghuo de juda binhua* [The big change in Chinese peasant life] (Beijing: China Statistical Publishing House, 1984), pp. 27, 67, 70.

in the Chinese economy. One is the process of collapse of the system of self-supply and self-sufficiency through the spread of the commodities and currency and may be termed the conversion to a commodity economy. The other is the introduction of the market mechanism into the planned economy and may be called the conversion to a market economy. Along with the progress of economic reforms and the open door policy since the end of the 1970s, there has been striking progress in the conversion of China to a commodity and market economy. In this regard, we may say, without exaggeration, that a qualitative change is underway.

## 2. Conversion to commodity economy in rural regions

In the urban regions or the mining and manufacturing sector, there has already been close to 100 per cent conversion to a commodity economy. At the present point of time, the conversion from self-supply and self-sufficiency to a commodity economy is an issue of the rural regions.

According to a Chinese national survey on farmer households, the percentages of self-supply and of purchases of commodities in expenditures of the farmers for daily life and expenditures for production are as shown in Table III. From the table, it will be seen that the percentage of purchases of commodities rose sharply from 1978 to 1983. As of 1978, the percentage of self-supply was still larger, but this situation changed completely by 1983.

However, the rate of self-supply has conversely risen in consumption of fuel. In the rural areas of China, firewood and stalks of farm produce (sorghum, corn, rice, etc.) have traditionally been used as the principal sources of fuel. Even today, 80 million farmers, corresponding to 47.7 per cent of all farmers in China, suffer from shortages of firewood for fuel for three to six months of the year.

For this reason, use is made of large amounts of crop stalks, leaves, roots, animal waste, etc. for fuel for cooking and heating. Under these conditions, in the past, crop stalks were also owned by the collective (production team). Under the recent family management system, however, it can now be used by individual homes. The rate of self-supply of fuel has risen as a result. The types of crops cultivated can also now be decided freely by the farmers, so a conversion may be underway to crops with long stalks in some regions.

Reeitsu Kojima gave as one of the reasons for the failure of the Great Leap Forward the collapse of the public dining halls due to fuel shortages and the crumbling of the collective economy [11, pp. 158–61]. Under the family management system now spreading in the rural regions, it is noteworthy that the rate of self-sufficiency in fuel has risen once again. The fuel shortages weakened the collective economy during the Great Leap Forward. At the present stage, it may be said to be strengthening the foundation of the family management system.

### 3. *Degree of conversion to market economy*

Let us now examine how far the market mechanism has been introduced into the economy through three types of routes for distribution of commodities.

First, let us look at the pricing system of production goods distributed among state-run enterprises. As already mentioned, there has been a great fall since the 1970s in the percentage in total production of the production goods which the government distributes under central government plans.

Among the production goods no longer under the distribution plans of the central government are those for which the local governments have broken down distribution plans to the individual enterprises. However, not everything is incorporated into the local plans. Fifty per cent of the total coal production is left out from the central government distribution system. Half of this is produced by locally administered state coal mines, but the other half is produced by collectively or individually managed mines and is sold at market prices.

According to a paper by Li Wenzhong, production goods outside of the central government's distribution plans (in terms of percentages of total production, 50 per cent of coal, 40 per cent of steel materials, 60 per cent of lumber, and 75 per cent of cement) are in reality distributed at market prices [14, p. 23].

Further, even among production goods produced by coal mines under the unified central planning system, enterprises are allowed to sell on their own the portion of their production over the targets of the production plans. The prices in that case may be determined by negotiations among the enterprises concerned. In the case of steel materials produced by state-run steelmaking plants, the rate of such independent sales reached 23.5 per cent of the sum total produced by these plants in 1980 and 30.2 per cent in 1985 [28, 1986 edition, p. V-32].

Second, let us look at the price of agricultural produce offered for sale by farmers. In 1985, the value of agricultural and sideline produce sold from the rural to urban areas reached Rmb 168 billion. This corresponded to 47 per cent of the total agricultural and sideline production in 1985. This figure does not include sales among farmers and thus, strictly speaking, is of dubious value,

TABLE IV  
COMPOSITION OF SALES OF AGRICULTURAL AND SIDELINE PRODUCE

	1978	1979	1980	1981	1982	1983	1984	1985
State listed prices	84.7	71.7	64.4	58.2	57.5	48.0	33.9	32.1
High prices for above quota purchases	7.9	16.7	17.9	20.9	20.8	28.1	33.6	
Negotiated prices	1.8	4.9	9.5	11.5	11.5	13.4	14.4	51.2 <sup>a</sup>
Free market prices	5.6	6.7	8.2	9.4	10.2	10.5	18.1	16.7

Sources: [18, 1985 edition, p. 479] [18, 1984 edition, p. 365] [8, March, 3, 1986].

Note: Higher prices for above quota purchases prices are by definition included in state listed prices. However, the state listed prices in this table mean the lowest purchasing prices, i.e., the *pingjia*. In 1985, the prices for purchases by order are also included in the percentage of 32.1.

<sup>a</sup> Negotiated prices and floating prices.

but it may be viewed as the rate of commercialization of agricultural and sideline produce. Among this, 32.1 per cent was comprised of purchases at the state listed prices, 51.2 per cent of purchases at negotiated prices or floating prices, and 16.7 per cent of purchases at free market prices [9, March 3, 1986]. If the transactions at prices other than the state listed ones are defined as the conversion to the market economy, then the rate of conversion to a market economy in sales by farmers of agricultural and sideline produce in 1985 (to total volume of sales) was 67.9 per cent (see Table IV).

Third, there are consumer goods sold from the state-run commercial sector to the consumer. In industrial manufactured goods, from 1982 to 1983, unified state price controls were abolished over 510 daily necessities. In addition, floating prices were introduced by the Ministry of Electronics Industry and the Ministry of Machine-Building Industry. However, the prices of consumer goods have a direct effect on the people's lives and they have been left under strict control under the state plans. Though the state control of the category III commodities (miscellaneous goods) has been relaxed since the 1950s, state listed prices are still enforced for 120 daily necessities among the category III commodities.

In retail sales to the consumer, prices of vegetables, fruits, meat, and fish were liberalized in 1985. Once the state guided prices for state-run stores also come under the scope of the market economy, the supply of vegetables, meat, etc. will in principle become adjusted by the market. In Beijing, these secondary foods account for as much as 30 per cent of total retail sales. Further, recently, the transactions of these goods on the free market have come to account for over half of all retail sales of them, as shown in Table V. The transactions on the free market may be said to be completely uncontrolled and left to market adjustment.

Above, we looked at the degree of introduction of the market mechanism in the distribution routes of various commodities. Industrial manufactures used as important production goods and consumer goods still remain under strict control of the state plans. While not mentioned here, charges for movies, public baths,

TABLE V  
 PERCENTAGE OF NATIONAL RETAIL SALES  
 IN JANUARY TO SEPTEMBER 1985

	State-run Commerce, Supply, and Marketing Cooperatives	Free Market
Vegetables	28.3	71.7
Pork	40	60
Eggs	29	71

(%)

Source: [9, December 20, 1985].

transportation, and other services are also predominantly set by the state. However, the reforms have been resulting in a definite increase in the role of the market in the Chinese economy and the trend is expected to continue in the future.

### C. *Multilevel Price System*

#### 1. *Multilevel price system resulting from reforms*

The introduction of the market mechanism which has gone on in China since 1978 has led to the parallel existence of various types of prices in addition to state decided prices. We shall refer to this as the multilevel price system. The multilevel price system results in different prices established for the products of the same type and same quality depending on the differences in the way of planning and the distribution routes.

Unprocessed coal under the unified central planning system was raised in price in 1979 by Rmb 5 per ton to Rmb 20 to 21. As of 1983, however, 65.6 per cent of the coal mines under the unified central and planning system still ran a deficit. The difference between the domestic price of coal and the export price is as high as Rmb 90 to 120 per ton [19]. The price of coal was again adjusted upward in March 1985 to Rmb 24 to 25 per ton.

In addition to the coal produced by the mines under the unified central planning system, there is coal, 50 per cent of the total production, produced by state-run mines under the control of province, prefecture, county, and other local authorities and mines run by collectives and individuals. The state decided price for state-run mines controlled by the local authorities, which account for 20 per cent of the total production, is Rmb 5 to 10 higher than that of the coal mines under the unified central planning system. Further, the coal mined by farmers in collectives or individually accounts for over 30 per cent of the total national production and is priced by the market, going for anywhere from Rmb 8 to 140 per ton.<sup>5</sup>

Steel materials are priced in diverse manners, with state unified planned prices, local order prices, import premium prices, floating prices under the Ministry of Metallurgical Industry, and independent sales prices for production in excess of the plan quotas (market regulated prices). The market regulated prices are two to three times the state unified planned prices [22, p. 43].

<sup>5</sup> Hearing at Price Research Center of the State Council, November 13, 1986.

Before 1978, when strict controls were enforced under the state plans, prices were ostensibly uniform, with the exception of black-market prices, though perhaps not completely the same for the same goods. The uniformity of prices destroyed the incentive of enterprises to improve their operations. In this sense, the rise of multilevel prices has stimulated effort on the part of the enterprises and promoted the increased supply of various goods, in particular production of energy and raw materials. Further, reinvestment of the funds earned through the higher prices can help the adjustment of the investment structure, if reinvested. This also is eliminating the old problem of the waste of domestic resources, which in spite of their high costs were used instead of the relatively more advantageous utilization of overseas resources due to the low prices set for them by government policy. Compared with the old administrative planning system, the present-day system is far more fluid.

On the other side of the coin, however, the existence of the multilevel prices is creating several problems. Plan targets have failed to be met due to increases in market sales, goods have been diverted, and black markets have been born in an increasing number of cases. Rather than a "fusion between planning and the market," the present situation may more appropriately be called as a "mish-mash of planning and the market." According to a survey by the Price Group of the Research Center Under the State Council to Advise on Economic, Technological, and Social Development, the following problems have arisen [17, pp. 9-10]:

(a) Enterprises which have to sell their manufactured goods at fixed prices, but procure the raw materials for the same at market prices are blocked from normal business activity due to rising costs.

(b) Enterprises are allowed to sell production in excess of state quotas on their own at several times the set price and so expend their energy on such independent sales and no longer fulfill their supply obligations under the state plans.

(c) Resales, falsified sales, illicit diversion, and other practices are spreading and black markets are being established.

(d) An overall rise in commodity prices has occurred. Despite the 1984 rise in state decided prices of production goods having been small, there were large hikes in prices for independent sales by enterprises outside of the state plans. In the beginning of 1984, the prices set autonomously by the enterprises were 30 per cent higher than the state decided prices, but in the second half of the year rose to two to three times the state decided prices for steel materials, automobiles, coal, ingots, lumber, cement, and refined soda [28, 1986 edition, p. IV-41]. Before February 1985, controls existed over the margin of fluctuation of prices for independent sales by enterprises—banning them from being more than 20 per cent above or below standard prices. After February, even this ceiling was eliminated.

## 2. *Multilevel prices resulting from open door policy*

When foreigners use transportation, hotels, etc. in China, they are asked to pay in foreign exchange certificates (issued starting April 1980). Also, while enjoying no better train seats, hotel rooms, and other services, they have to pay

several times the rates of native Chinese. In other words, there are special higher charges for foreigners. Starting April 1985, the room and dining charges of hotels of Chinese-foreign joint ventures (equity joint ventures or contractual joint ventures) have been left to the decision of the individual hotels [7, p. 56]. The rates for state-run hotels, on the other hand, have remained as officially set. This is resulting in further diversity in prices.

Conversely to the above, there are also cases where prices are lower when foreign exchange certificates are used. In general, the friendship stores around the country are set up for foreign and overseas Chinese customers and ask for purchases to be paid for by foreign exchange certificates (or renminbi with foreign exchange certifications attached). Depending on the product, two prices are sometimes displayed: one for renminbi and one for foreign exchange certificates. In such cases, the price for foreign exchange certificates are 20 to 30 per cent lower.

The above-mentioned situation has arisen because the economy had to be opened up after long years of separation between international prices and domestic prices. The nonconvertability of renminbi to foreign currencies and the use of an internal rate for trade settlements in the period 1981-84 also reflect the problems faced by China.

### CONCLUSION

It will be no mean feat for present-day China to realize guided market economy it is aiming at, looking just at the problems in the determination and utilization of such economic regulators as prices, taxes, and interests. The author discussed the necessity of price reforms after the start of the economic reforms in [6, pp. 9-10]. The unreasonableness of the price system is the result of long years of abuse of the economy and cannot be put right overnight. As the Chinese put it, "the three feet of ice under your feet is the result of a lot of cold days in the past" [3, p. 30] [19]. This is all the more true due to the sheer size of the population and land area.

The issue which will arise from now is, on the one hand, how to gradually change over from administrative control by central government and local government plans to control through economic means and, on the other, what way to use economic regulators to guide sectors of the economy no longer under the plans (including black markets). The spread of multilevel prices is one problem which has occurred in the transition period from a mandatory planned economy to a guided market economy. China has indeed taken the first steps toward a guided market economy, but it still has a long way to go.

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