ECONOMIC REFORM IN THE PRC

In Which China’s Economists Make Known What Went Wrong, Why, and What Should Be Done About It

Edited and translated by
George C. Wang
ECONOMIC REFORM
IN THE PRC
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In February 1978, the post-Mao leadership revealed an ambitious ten-year program (1976–1985) with a $600 million capital outlay, aimed at propelling China into the front ranks of the industrialized nations by the year 2000 through the modernization of agriculture, industry, science and technology, and defense. The new leadership soon realized that such a program could hardly be implemented without reforming China's economic system, which—modeled in the 1950s after that of the USSR—has been plagued by structural imbalance, inefficient management, and an overcommitment of resources to capital construction projects. By the end of 1978, a policy of "readjustment, consolidation, restructuring, and improvement of the economy" had been introduced.

In this book, distinguished Chinese economists offer candid analyses of the strengths and weaknesses of the present system. Their lucid and penetrating comments on the virtues—and drawbacks—of that system lend insight to our comprehension of China's economic problems and the country's prospects for the future. Each article is based on firsthand information and data, much of which is available here (in English) for the first time.

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edited and translated by George C. Wang
To: Jo Anne
   Pearl
   Andrew
   Kenneth
   James
   Joan
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Preface

For a period of more than twenty years after the founding of the People's Republic of China in 1949, China maintained little contact with the Western world. The lack of dialogue, particularly between the United States and China, precluded any normalization of their strained relations. Because of the paucity of information, studies on China in the past were more pedagogic inferences based on secondhand sources than scientific research based on firsthand data.

On February 28, 1972, former President Richard Nixon and late Premier Zhou Enlai signed the Shanghai Communiqué, thus symbolizing the end of twenty-three years of containment and confrontation and the dawning of a new era of conciliation and rapprochement. In a short span of ten years, 1972–1981, the two countries established diplomatic relations and granted reciprocal most-favored-nation tariff treatment. Since the normalization of relations, the U.S.-China trade has grown by leaps and bounds; from a few million dollars in 1972 to probably over US$6 billion in 1981.

The two governments have also exchanged numerous delegations and scholars and have concluded several agreements, especially in the fields of science and management and in matters affecting trade relations. On December 28, 1979, thirteen social scientists and humanists—representing the Joint Committee on Contemporary China (of the American Council of Learned Societies and the Social Science Research Council) and the Committee on Studies of Chinese Civilization—undertook a visit to China.

In March 1980, at the invitation of the Economic Information and Agency in Hong Kong, a Chinese economic delegation visited Hong Kong and conducted several seminars there, including one at the University of Hong Kong. Xu Dixin, vice-president of the Chinese Academy of Social Sciences, headed the delegation. Six papers were presented at the conference, covering China's economic policies in general and foreign trade and investment in particular.

In the fall of 1980, another Chinese economic delegation visited
Hong Kong, this time headed by the renowned Chinese economist Xue Muqiao, formerly vice-minister of the State Planning Commission and director of the State Statistical Bureau and now adviser to the commission. At this seminar, five papers dealing with various aspects of the economic reform were presented.

On March 23–28, 1981, the Chinese Academy of Social Sciences and the Stanford Research Institute International jointly sponsored a symposium on world economy in Hangzhou. For the first time in three decades, Americans and Chinese shared a table to exchange candid views, despite their differences in value systems and in social orders.

This book is a collection of ten papers from the above-mentioned conferences and seminars, and the papers give English readers the Chinese views of the strengths and weaknesses of China's economic system, its achievements and setbacks, its therapies and prospects. These articles are addressed not only to China specialists, but also to people who are interested in a more general overview of international trade and economic development in China.

The editor wishes to express his gratitude to the authors for their permission to have the papers translated and published in English. I am particularly indebted to Xu Dixin and Yu Guangyuan, vice-presidents of the Chinese Academy of Social Sciences; Xue Muqiao, adviser to the State Planning Commission; Chan Parkqun, editor-in-chief of the Economic Information and Agency; professors Dong Furen and Liu Guoguang; and Rio Liang for helping with the pinyin spelling. I am indebted to Megan L. Schoeck, copy editor, and Deborah J. Lynes, associate editor, of Westview Press for their painstaking work and professional advice, which saved me from many errors.

Additionally, I would like to acknowledge the generous financial and administrative support provided by the United States International Exchange of Scholars Agency, California State University, Dominguez Hills, and the University of Hong Kong. Needless to say, without the personal efforts of the individuals and the support of the institutions, this book would not have been possible.

George C. Wang
Introduction

George C. Wang

The People's Republic of China is in the throes of a sweeping reform of its entire economic system. This reform is China's fourth modern attempt to overhaul a now-faltering system, which grew out of years of protracted guerrilla war and was modeled in the 1950s on the system of the Soviet Union.

During the 1949-1952 period of rehabilitation and the First Five-Year Plan (1953-1957), China's economic performance was impressive, but after 1958, it faltered, and it has never regained the momentum of those early periods. As a result, there have been repeated calls for reforms.

The beginnings of those major reforms date back to 1958 when the revolutionary government first decided to relinquish some of its central powers of economic control. At that time, 87 percent of the Chinese state enterprises, which had been managed by various central government ministries, were turned over to local provinces, municipalities, or autonomous regions. However, that change in management merely shifted the level of administration, and the enterprises remained as appendages of various local ministries and departments. Ultimately, those enterprises that were handed down to local governments during this first reform were returned to the control of the central government, and by 1961, economic management had slipped back to its pre-1958 centralized structure.

In 1964, a second reform took place. This time, the central government delegated to local governments the power to allocate funds and construction materials for nonindustrial projects, such as communication systems and water conservation projects. This reform, too, fell short of its goal, and the system again reverted to its original, centralized rigidity.

A third reform was launched in 1970. Of a total 400,000 state-run enterprises, the managerial control of some 2,000 large ones was once again transferred to the local provinces, municipalities, or auton-
omous regions. In allocating resources to these key enterprises, the controlling power was shared by the central government and the various local governments.

Like the previous attempts, this reform again failed to fundamentally restructure the economy; i.e., to allow an enterprise to operate as an independent economic entity, responsible for its own profits and losses. Judging by the reports and literature now available, observers can reasonably assume that at least some of the Chinese economists and planners were aware of the drawbacks but were unable to carry out any really meaningful reform as long as Mao Zedong remained alive and in power.

By early 1977, the new post-Mao leadership had already begun to try again to rejuvenate the Chinese economy by reinstating the four modernizations program, which had been announced a few years earlier by the late Premier Zhou Enlai. Indeed, the goal of this massive program was to propel China into the front ranks of the industrialized nations of the world by the year 2000 through modernization of agriculture, industry, science and technology, and defense. To lay the groundwork for achieving the four modernizations, a ten-year economic program (1976–1985) with very ambitious targets was drafted and revealed in February 1978.

It did not take long for the new leaders to recognize that the plan simply exceeded China's resources and capabilities. By 1978, a nationwide survey of China's natural resources, capital construction requirements, and available trained manpower, as well as research into the existing economic management practices, had given Chinese planners a much firmer grip on their nation's economic problems. By the end of 1978, the central leadership had concluded that a new three-year period of economic reform (1979–1981) was necessary.

A rolling policy of "readjustment, consolidation, restructuring, and improvement of the economy" was introduced. This new policy called for a readjustment of the imbalances among various basic industries in the national economy and for a significant shift of national resources away from heavy industry and into agriculture and light industry. Further, resources were proportionally allocated to housing, education, and scientific research. In the heavy industry sector, efforts were directed toward increased output of coal, oil, electric power, transportation, and building materials—all areas in which supply is lagging behind demand. Relief of shortages in these areas alone, it has been reported, can raise China's industrial output by 30 percent.

Since the introduction of the Ten-Year Plan in 1978, production goals for key commodities, such as grain and steel, have been revised downward. A number of steps have been taken toward a retrenchment
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in capital construction investment, including investment for such extensive projects as the Baoshan Iron and Steel Complex and the Daqing Petrochemical plant.

These current reforms have affected not only China's domestic economy but China's foreign trade as well. The shift in priorities from heavy industry to agriculture and light industry has resulted in an increase in China's imports of grain and cotton from the United States and a scaling-down or suspension of further imports of certain capital goods from Japan.

Why did an economy that performed reasonably well during an early period of economic development run into various difficulties after 1958? What are the strengths and weaknesses of an economic system that evolved out of protracted guerrilla warfare and, after liberation, was modeled on the Soviet Union's system? Can the drawbacks and shortcomings be solved within the timetable set by the ambitious program?

Most Western studies on China and its economy have historically been based on fragmentary data and unverifiable sources, but since the normalization of relations between the United States and the People's Republic of China, there has been a sudden and active exchange of scholars and information. More recently, the reinstatement of China as a member of the World Bank and the International Monetary Fund has made available further vital statistics on that country's economic development. For the first time in more than three decades, it is now possible to make scientific economic studies of China and to draw objective conclusions.

This book is an attempt to find the answers to many of the questions directly from the work of Chinese economists and planners themselves. Each of the ten articles following addresses some aspect of the current economic reform, and each was selected for its contribution to an understanding of the problems facing the Chinese economy and the proposed antidotes to solving China's economic ills. Obviously, informed readers will not accept the Chinese economists' views presented here without applying their own reasoning and analyses. Yet to study China without listening to the Chinese economists presenting their views about their own problems would be a totally incomplete study, if not a biased one.

The initial chapter by Xue Muqiao, former vice-minister of the State Planning Commission, was chosen for its totally realistic assessment of the achievements and failures of the Chinese economy over the past three decades. Xue pinpoints where, when, and how the economic policies went astray. During the 1949–1952 period of rehabilitation, when peace and order were finally restored, China's economy grew at a
rapid rate. Despite a war-devastated society, the ambitious First Five-Year Plan (1953–1957) was successfully carried out, and it laid the foundation for a more modern economic structure. Xue himself attributes this success to effective policies pursued during the period 1949–1957.

After 1958, the economy faltered. Xue blames a slowdown in agriculture on haste in collectivizing the ownership of land, farming tools, and agricultural animals. Another blunder cited by Xue was China's lopsided stress on developing heavy industry at the expense of not only agriculture and light industry but general Chinese living conditions—particularly housing, hospitals, medicine, and education.

All of those failures dampened the Chinese people's enthusiasm and hope for any realistic improvement in the nation's standard of living. Not until the post-Mao leadership came into power did the Chinese government have an opportunity to address the failed policies of the past and attempt to reform the system. Although asserting the continuing necessity of planning for economic development, Xue contends that the implementation of any plans should rely more on the proper role and use of the marketplace, and pricing and fiscal policies, than on administrative decree. He is confident that once reform is completed, the economy will regain its lost momentum. He warns clearly, however, that modernization of an ancient China cannot be achieved overnight.

Xue's second article was chosen for his penetrating analysis of the drawbacks in China's economic management system. Xue points out that in a system in which enterprises are not held responsible for their own profits and losses, they have little incentive to improve the quality of their products or to lower costs. Nor will workers strive for high productivity in a system in which they can always be hired but never fired. Xue attributes all these difficulties to an overcentralization of economic power in the hands of the state.

All economic activity in China is planned by the state, and fixed production and sales targets are handed down to various regions and enterprises with little attention paid to local and regional conditions or climate. Such a centralized and rigid system runs directly counter to any principles of division of labor.

One of Xue's great contributions in this book is his drawing of conceptual differences between microeconomics, i.e., the rational behavior of enterprises, and macroeconomics, i.e., the role of the government. In the past, Chinese decision makers seem to have confused the government's function, which is to formulate policies and lay down rules conducive to economic development, with the enterprises' own function, which is to turn out products that are high in quality and low
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in cost. The difference is a vital point in analyzing and understanding China's present economic reforms.

To overcome China's difficulties, Xue suggests the following reforms: (1) the enterprises should be responsible for their own profits and losses; (2) instead of the state's randomly allocating resources, local enterprises receiving construction funding or working capital ought apply to state banks for the money; (3) enterprises should retain the right to reduce the work force, when necessary, and to dismiss employees, when justified; and (4) responsibilities of managers, chief engineers, accountants, and Party committee members should be clearly defined so that one does not interfere with another.

The third chapter, by Xu Dixin on the characteristics of the Chinese approach to the problem of industrial modernization, was chosen for Xu's practical suggestions for reforming the present system. Xu, vice-president of the Chinese Academy of Social Sciences and a renowned economist who has visited the United States several times, stresses the necessity of proceeding with the four modernizations in accordance with the realities of the situation in China. Since China is overpopulated, Xu contends it should adopt labor-intensive methods in this modernization, and since the economy is woefully underdeveloped, Xu calls for an acceleration of development through the importation of advanced technology and modern industrial equipment.

Xu predicts that China may have to import complete sets of plants during the 1980s. He foresees that the nation will gradually develop its own technology and learn how to manufacture its own modern equipment. He expects some sectors of the Chinese economy may even slow down during the period of readjustment, which will temporarily affect imports, but such a pause is necessary, according to Xu, for it will pave the way for future development. Once the readjustment is complete, he anticipates that the economy will grow at an even faster rate than before.

The fourth chapter, by Dong Furen, a member of the Chinese Academy of Social Sciences, deals with the problems of optimizing levels of accumulation of capital, which will maximize rates of economic growth. Dong traces China's present accumulation to three major sources: (1) the rents peasants paid to landlords before the liberation are now being tapped for capital formation; (2) the immense wealth amassed by "bureaucratic capitalism" under the Guomindang—probably also by Japan during World War II—is now being converted into productive capital; and (3) the current rapid increase in national income.

Dong focuses his analysis on the relationship between the level of accumulation and the rate of economic growth. He points out that
although the national income grew at a high rate during 1949–1957, consumption and accumulation rates both rose steadily. Investment was efficient—for every 100 yuan accumulated, an output of 35 yuan was generated—and the economy reached full employment in 1956. All those accomplishments were achieved with a relatively low level of accumulation—about 24 percent of the national income—while foreign loans, mostly from the Soviet Union, accounted for less than 2 percent of the state budget.

In contrast, during the Great Leap Forward, the level of accumulation rose sharply, and the rate of economic growth plunged. This situation reminds people familiar with Keynesian economics of the "paradox of thrift." In China, however, the fall in the rate of growth was not so much due to a deficiency in aggregate demand as to shortages of capital goods and building materials brought about by a higher level of accumulation. Consequently, many existing factories operated at less than full capacity, and new projects under construction were suspended or left unfinished. The same 100 yuan, Dong demonstrates, generated far less output than before, and the rate of growth slowed down.

Although one recognizes that Dong's empirical study of China's accumulation/output ratios for the past thirty years is a contribution to the literature, it must be pointed out that in an economy in which agriculture is a predominant sector, fluctuations in the ratios can be caused by changes in the weather. Further studies are badly needed to determine how much of the slowdown in economic growth was due to overaccumulation and how much to unfavorable Chinese weather conditions.

The fifth chapter, by He Jianzhang, deputy director of the Economic Research Institute, was chosen for his systematic treatment of the errors in China's economic policies. His analysis focuses on four areas: (1) policies for rural areas; (2) policies on the collectivized economy and individual enterprises; (3) policies on competition and comparative advantages; and (4) policies on pricing.

One of the worst blunders of China's policies in the rural areas, according to He, was the blind pursuit of egalitarianism and too much haste in pushing farmers to join communes. Those ill-conceived policies dampened the peasants' enthusiasm and adversely affected agricultural production.

In cities, in the collective economy sector—such as restaurants or handicrafts—as well as in the individual economy sector—such as repair shops or house services—everything was hastily organized into state-run departments. He Jianzhang claims that this policy not only brought inconvenience to people, but also created substantial urban unemployment.
Another policy error cited in this chapter was China's one-sided stress on autarky for individual regions and enterprises. There was a great deal of overlapping between enterprises themselves and duplications within regions, but little competition anywhere. The policy weighed against the very principles of division of labor and of comparative advantage.

He Jianzhang calls for reform of the present price system. Many commodity prices are above cost, and others are below cost. The suggestions he makes are (1) the state set the rules by which the local governments can administer prices, (2) the state set the limits within which prices may float, and (3) the enterprises be allowed to adjust prices in light of seasonal fluctuations or variations in supply and demand. Although He's chapter is a contribution toward improving China's present price system, it falls short of specifying how to determine the value of the factors that go into a product. As long as costs of production cannot be scientifically determined, it will be difficult to have any price system that will lead to an optimal allocation of scarce resources.

The sixth chapter, on the restructuring of the management of China's present economic system, was a paper presented by Liao Jili at a seminar held in Hong Kong in 1980. Liao, a senior member of the State Planning Commission, finds the present structure, patterned after the economic system of the Soviet Union, incompatible with the complexities of any modern operating economy.

Liao points out four major drawbacks. First, the economy is so centralized and the enterprises so tightly controlled that neither local governments nor the enterprises themselves have an incentive to practice economy or increase efficiency. Second, all geographic regions, regardless of comparative advantages, were told by the state to produce the same or similar products. Thus, all enterprises, ignoring intrinsic interindustrial relationships, which are dictated by production technology and market forces, strove for autarky. This practice ran headlong into the principle of division of labor and became a stumbling block to any increase in technology.

Third, Liao attributes past economic chaos to inflexibility of state planning, which left few options open for regions and enterprises to exercise their own discretion. The last, but not the least, defect in the economic structure, according to Liao, was an egalitarian wage scale. (For a labor force of 400 million, wage scales consisted of only eight grades, ranging from approximately 35 to 120 yuan per month.) The contribution of this chapter lies not so much in these analyses as in its up-to-date study of the current experiments in local enterprise self-management.

Chapter 7, by Liu Guoguang and Zhao Renwei (the former an acade-
mician in the Chinese Academy of Social Sciences and the latter a senior researcher in the same academy), was selected for the insight it throws upon the role of the marketplace in China. The authors blame the failure of the marketplace to play a greater role in regulating economic activity on a misconception held by some Chinese economists who contend that economic planning and the marketplace are mutually exclusive: The more extensive the planning, the better the economy. The two authors hold the contrary view that economic planning and the marketplace are complementary and propose that in the current reform, the marketplace must be allowed to play a greater role in regulating economic activity.

They say that in the absence of the marketplace, commodity transactions will require either barter or ration and allocation. If carried out by barter, the division of labor is impeded, which will cause a return to a primitive economy. If carried out by state rationing, the enterprises may produce items that are not what people need; or conversely, what people need may not be produced. Moreover, without a marketplace, there is no way consumers can express their preferences, and it is difficult to determine what should be produced and how much.

As the two authors also point out, many commodity prices in China no longer reflect actual costs because of restrictions on the role of the marketplace. These restrictions not only breed waste in production but preclude any practice of economic accounting. Although the authors suggest allowing the marketplace to play a greater role in regulating economic activity, they do not spell out clearly how economic planning and a real marketplace should be integrated.

The eighth chapter, on foreign investments in China by Ji Chongwei (a senior member of the Commission for the Administration of Imports and Exports), was presented at a world economy symposium held in Hangzhou, China, in 1981. Ji predicts that China will continue to pursue an outward-looking policy for the present as well as for the foreseeable future. High priorities for foreign investments in China will be accorded to development of energy, particularly coal and petroleum; transportation and communications; and other small or medium-sized projects that require little investment but that can lead to quick and lucrative return.

Historical foreign investments in China, Ji says, have taken many forms, but long-term loans are now the primary source of the country's external finance. China is reported to have reached agreements with Japan, the United States, and members of the Common Market for a total loan amount of more than US$20 billion.

Up to now, however, little of these loans has been used, partly because of high interest rates and partly because the equipment and machinery imported by China in the late 1970s were more than China
could absorb or utilize. As a member of the World Bank and the International Monetary Fund, however, China now has access to Special Drawing Rights and other credit lines from those two UN agencies.

Another form of foreign investment, the joint venture, means that foreign investors provide the technology and equipment and China comes up with the land, the labor, and the raw materials. Most of the joint ventures are to establish hotels, public services, and some manufacturing. China has also signed contracts with foreign companies to exploit its offshore oil. A fourth form of foreign investment is called compensation trade, i.e., China will use the finished product to pay for the foreign investment employed to produce it. Finally, China is earning foreign exchange by leasing its own land and facilities.

The ninth chapter, on China's foreign trade, by Zhang Peiji (deputy director of the International Trade Research Institute, Ministry of Foreign Trade), was chosen for its analysis of the new trends in that country's foreign trade. In contrast to the past, the central government encourages certain provinces and municipalities to engage in foreign trade and to tap their own comparative advantages. The quality of their exports is emphasized rather than their quantity. Representatives of the local producing enterprises join teams from the central ministry of Foreign Trade to negotiate the contracts.

As for China's trade prospects in the 1980s, Zhang predicts the country will continue to import grains, cotton, and industrial equipment and export textiles, nonferrous metals, and petroleum. Once the present reform efforts are completed, Zhang expects the volume of trade to grow at a much faster rate.

It is pointed out, however, that China must first work out a realistic pricing system, a rational international division of labor based on its comparative advantages, and an efficient as well as a comprehensive world trade network, including insurance, banking, shipping, and market research. Without such a well-coordinated, coherent system, it would be difficult for China to make a really significant breakthrough in its international trade.

Chapter 10, by Dong Furen, is concerned with the transformation of ownership of the means of production. This analysis was selected for its insight on the question, What led to China's historical economic blunders? Dong puts the blame on misconceptions that were embedded deeply in the minds of the Chinese high authorities who made the strategic economic decisions. They held the view, wrongly according to Dong, that public ownership of the means of production is unconditionally superior to collective ownership and that collective ownership is preferable to individual ownership.

Guided by this misconception, the Chinese leaders pushed
prematurely for collectivization and communization throughout the country. Chinese peasants were not ready for such sharp social changes, so they slaughtered their livestock and destroyed their orchards, both dampening people's enthusiasm and retarding agricultural production. In the cities, too, peddlers, repairmen, and other traditional individual and personal services were hastily turned into state-run enterprises. By 1960, Dong reports, there was not one single-individual labor enterprise operating in Beijing. Unemployment emerged, and entire trades of individual-service businesses were wiped out.

Another misconception held by the high authorities was that despite the underdeveloped state of the economy, China could skip the stage of commodity production in which products are distributed to each according to his work and enter communism, under which products are distributed to each according to his needs. Legitimate claims of compensation for work performed were seen by the high authorities as an evil legacy of capitalism that should be eliminated, and the sooner the better. And finally, Dong says, state ignorance of what the Chinese people saw as their welfare and material interests caused even further setbacks in the Chinese economy.

The ten chapters, though different in approach, share the conviction that the nation's economy will resume its thrust of sustained growth once the policy errors have been threshed out and the drawbacks removed. It is difficult to evaluate that assertion. Economic development is a highly complex process involving a host of tangible and intangible factors, and their actions and interactions, but measured in terms of the tangible factors, i.e., the advanced technology and modern industrial equipment, China's prospects for achieving its goals before the year 2000 are promising.

It is the intangible factors that the nation will have difficulty dealing with. The critical question for China, and other developing countries, is how to mold, within a short span of time, work ethics, incentive, morality, and above all, a mentality that fits modern life and is conducive to economic growth. Such an attitude can be developed, but it may take more than twenty years.
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