



Taking up the slack

China's 'commodity economy' has thrown up some strange by-products. Kate Hannan examines the numerous problems of the rural sector.

On a centralised economy, albeit one that contains a market sector, the twin problems of slack demand and rising unemployment are, to say the least, unusual. Until these problems emerged economic 'wisdom' had it that China has a suction-based economy that manifests scarcity, but provides full employment.

Today China's economic planners find that they are faced with a situation where a significant number of enterprises are being merged with other enterprises or are closing, where an additional 130 million people will enter the workforce in the next ten years and, where economic policy must address the problem of a 'vicious circle' of over-extended enterprise circulating funds created by slack demand.

In an attempt in part, to unravel the current twin problems of a slack demand and rising unemployment I will begin by considering two factors - (i) the behaviour of advantaged state industrial enterprises, both during and after the decade of economic reform and (ii) the process of accumulation and investment

that took place during the decade of reform, particularly in the rural sector.

During the decade of reform, China's economic planners assumed that reform policy would increasingly result in competition between enterprises and that this would be competition for profit. Indeed, economic reform policy did create competition between enterprises, but, rather than competing for profit per se, they competed for access to scarce production resources, the same resources now subject to demand slackness.

Under China's economic reform policy, enterprises increased production and economised on resources, as intended, but they also continued to measure enterprise 'success' by the size of production output. The latter is a characteristic of a suction-based economy where consumer demand does not inform production output, rather scarcity allows almost all products produced to find a willing consumer. As reform policy increasingly allowed enterprises to retain a significant portion of their profit, competition between ever-expanding enterprises took the form of competition for scarce production resources. In this

situation a cycle of shortage was fed, and advantaged state industrial enterprises gained an 'edge': an 'edge' consisting of access to scarce producer resources through an ability

- to pay above the formal price for scarce resources,
- to barter for scarce resources,
- to cultivate favour advantages,
- to enjoy a relatively strong bargaining position vis à vis administrative authorities at all levels,
- to provide private infrastructural resources (i.e. a coal-burning electric plant), and
- to attract scarce technically trained labour-power.

Given their competitive 'edge', advantaged enterprises were in a position to reproduce and enhance their already favourable position and were generating a considerable call on funds over which enterprise management could exercise decision-making power unimpeded by the direct control of central planners. At the same time, state central planners, aware of above-price payment for scarce resources, aware that these prices were fuelling inflation and aware that fixed-asset investment was escaping state planning control, attempted to exert

greater influence over the use of enterprise funds. In this context the advantaged enterprises came up with an economic innovation allowing them to tap funds that, like retained enterprise profit, lay outside direct central government control. These were the investment funds of township enterprises.

The advantaged enterprises' call on non-centrally controlled funds, then, led directly to the exploitation of township funds by state industrial enterprises. They were thirsty for ever-expanded production capacity (indicating enterprise 'success') leading to a need for more and more production materials to feed this capacity.

At the beginning of the decade of reform, central government policy was to close the 'price-scissors' - the process whereby rural production, through the price system, provided accumulation for urban industrial development. But, in the last years of the reform decade, the advantaged state industrial enterprises significantly contributed to the undermining of this policy by effectively opening up a new channel for tapping rural accumulation for use in urban industrial development. This was done through gaining access to township enterprise funds, themselves drawn in turn from a combination of rural agricultural accumulation and Agricultural Bank and agricultural co-operative loans designated for rural sector development.

And, in time, the policy of tapping township funds did not stop at channelling investment from the rural to the industrial/urban sector of the economy (indeed, it was accompanied by an urban consumption bias on a 2:1 ratio). During the period of economic contraction that has followed the decade of economic reform, another legacy of this policy became all too evident: township unemployment.

Clearly, future township unemployment was unforeseen. When township enterprises provided funds for advantaged enterprises, they saw themselves as investing funds in return for scarce production resources. They could not have known that in the post economic

reform climate of economic contraction and state anti-corruption control, advantaged enterprises would reduce their liabilities, not through reducing their core labour force, but through cutting their ties with satellite township enterprises. This has been a policy that has significantly contributed to the situation where three million township enterprises have been closed or merged and where there has been a corresponding decline in rural per capita income.

Under the economic reform policy the primary form of rural accumulation came to be private household production. This form of production provided funds for investment in the township enterprises, which



most often manufactured industrial goods rather than processing agricultural produce. Some became satellite enterprises by entering into contract arrangements with urban based state industrial enterprises. It was, as noted above, a situation whereby township enterprises provided funding for a form of industrial development outside direct state control.

Current [1990-91] policy has had to recognise that rural accumulation, instead of funding investment in industrial production, could be better used to support agricultural production. By 1990 the State was investing more than twice the 1988 figure in projects aimed at increasing farm production and central planners' economic statements no longer glowed with accounts of China's richness in terms of rural labour power resources. The argument was no longer being made that:

It is of great importance to transfer a large portion of

manpower away from farming to the secondary and tertiary industries and thus make full use of it...to develop diversified rural economies...¹

The corresponding argument now used was that:

The surplus labour force in agriculture should be absorbed and digested within the scope of agriculture. Agriculture is the foundation of national economic development. So long as agriculture continues to develop, it will be easier to arrange the rural labour force, and the cities will also find it easier to solve their employment issue...²

Planners are now recognising that rural industries are having a relatively "hard time". A 1990 survey of rural incomes showed that actual per capita income dropped by 4% and that for the first time cash income from township and town enterprises experienced negative growth. The survey showed that even such regions as Beijing, Jiangsu and Guangdong "whose economies have been developing rapidly at a high level" showed decreases in per capita rural income. In the face of this situation the Agricultural Bank of China has now been authorised to increase its lending to township enterprises by 11 billion yuan (\$A3.5 billion) to be used as working capital.

China's planners are now arguing that "the rural contracted responsibility system, based on the household and with remuneration linked to output, [the form of primary accumulation promoted during the decade of economic reform] should be further consolidated and improved"³ but that, the next accumulation and investment step promoted by economic reform policy, i.e., re-investment of funds accumulated in the course of private agricultural production or borrowed from rural bank and co-operative sources, will be blocked. This, it is currently argued, is "because the capacity of township and town enterprises is limited".

Currently planners have had to come to terms with a situation where "a part of the labor force they

[township enterprises] hired...[is being] laid off and sent back to agriculture" and, a situation where, "with limited scope for jobs in cities", "a substantial number of surplus labor forces in the traditional farming industry" must be expected.⁴

Under the Eighth Five-Year Plan [1991-7], the focus has shifted from industrial development *per se* to developing agricultural production, especially any available rural export potential, together with 'basic industries' such as energy and raw materials. Current increased loans to township industries involved in industrial production may thus be seen as paralleling past subsidies of the price of basic foodstuffs to urban workers, in the sense that they are loans designed to dampen the social dissatisfaction expected to accompany loss of real income.

Even allowing for the focus of the argument presented above, it would be wrong to blame all current unemployment in China, or even all township unemployment, on the behaviour of advantaged enterprises vis à vis township enterprises during the decade of reform. Other important factors must be recognised, the most important being problems of slack demand.

Chinese planners' analyses of the cause of current slack demand fall into two categories. The first attributes the problem to the recent substantial increase in savings deposits. The second, beginning from the premise that "reducing savings deposits will not help enliven the sluggish market", attributes it to a variety of inter-related factors. These include:

- (i) harsh contractive measures taken in the early period of economic contraction;
- (ii) greater screening and rectification of enterprise behaviour;
- (iii) effective measures to cut back government institutions' purchase of consumer goods;
- (iv) the current reduction in demand for materials for fixed asset development.

The second factor listed is, alone, recognised as having, by late April

1990, led to the closure or incorporation into other entities of more than 100,000 enterprises.

Policy consequent on such analysis has, since the third and fourth quarters of 89, been based on the view that the enterprise 'debt chain' that has arisen from enterprise inability to sell their product and so pay their debts, should be the first issue addressed. Bank loans have been used as a 'starting device'. Indeed, these are loans made possible by the current increased level of savings. It is estimated that "of the increased loans offered [to enterprises] by banks and credit cooperatives, two-thirds came from savings deposits".⁵

'The topics of conversation nowadays' are mostly about how



best to approach the problem of slack demand. But, in practice, policy has not consisted of the most discussed policy suggestions of readjusting the product mix, increasing production of those items which are readily marketable and in short supply, and, cutting back production cost and promoting sales, especially in rural areas.⁶ Instead, it has taken the form of the bank loans noted above and, even more recently, a clearly defined period of enterprise debt clearance. The latter consisting of bank assistance extended to enterprises specifically for clearing accumulated enterprise debts of over 50,000 yuan (\$A15,000) incurred between 1/1/89 and 31/3/90. It is assistance that carries with it very tight government control of enterprise funds.

A formal planning consequence of a decade of economic reform, fol-

lowed by a period of centrally induced economic contraction, is an Eighth Five Year Plan that moves China's planning focus from rural industrial to agricultural development and seeks to use the present period of economic contraction as "an opportunity" to influence investment in order to give priority to urban and rural infrastructure. But another consequence of this same period is that Chinese planners, are faced not only with a situation of merging and closing enterprises, but also with the need to dampen the social effects of rising unemployment as well as trying to break out of the vicious circle of:

Overspending of circulating funds—less investments in fixed assets for economic sectors short of funds...—uncoordinated investment structure—unbalanced production structure—further increase in the spending of circulating funds...⁷

The slack market that has led to this cycle together with the accompanying unemployment are very unusual concerns within the context of a centralised economy. Indeed, they are so unusual that the established wisdom of the economists of centralised economies is unable to help. Clearly, new theses are needed. These will need to be informed by an understanding of the effect of interacting central and private economic sectors within the frame of a centralised economy, together with perceptive analysis of the effect of centrally enforced curbs on fixed asset investment and on the corruption that "oils" a centralised economy.

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1. Lu Wen, Research Centre for Rural Development under the State Council, "Development Strategy in Rural China", in John W. Longworth, ed., *China's Rural Development Miracle*, Uni of Qld Press, 1989.

2. *Renmin Ribao*, 25/8/90.

3. This policy is quoted in a speech delivered by Li Peng, see *Xinhua*, 16/9/90.

4. *Renmin Ribao*, 28/8/90.

5. *Renmin Ribao*, 13/8/90.

6. *ibid.*

7. *Renmin Ribao*, 8/8/90.