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# ***JPRS Report***

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# **China**

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# China

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### Officials See New Understanding of Socialism Critical to Successful Reform

40050166 Chongqing GAIGE [REFORM] in Chinese  
No 6, 10 Nov 88 pp 5-21

[Text] Editor's Note: The current wave of reform has engulfed every socialist country with an irreversibility indicative of the inevitability of historical development. We carry out reform to improve and develop socialism further, not to repudiate it. But reform requires that we reinterpret socialism and redraw boundaries. This is a basic issue not only in Chinese reform, but in reform in all socialist nations. To understand socialism anew at a deeper level, the editorial department of this publication recently invited a number of experts and scholars in Beijing to a seminar. Participants included Yu Guangyuan [0060 0342 6678] (adviser to the Chinese Academy of Social Sciences and a well-known economist, Tong Dalin [4547 1129 2651] (deputy director of the Restructuring the Economic System Research Institute), Lin Zili at the State Council's Research Center for Rural Development), Gong Yuzhi [7895 5148 0037] (deputy director of the Propaganda Department of the CPC Central Committee), Zheng Bijian [6774 1801 1017] (vice president of the Chinese Academy of Social Sciences), Gui Shiyong [2710 0013 6978] (general secretary of the State Planning Commission), Wang Jue [3769 3778] (a professor at the senior party school), Jia Chunfeng [6328 2504 7364] (deputy director of the Theory Bureau of the Propaganda Department under the CPC Central Committee), and Wu Guoguang [0702 0948 0342] (editor-in-chief of RENMIN RIBAO). The seminar was presided over by our chief editor, Jiang Yiwei [5592 0001 5517]. Below are excerpts from the presentations of some seminar participants.

#### Yu Guangyuan: We Must Study the Characteristics of the Contemporary Socialist Society

The theory of the initial stage of socialism necessarily involves some basic issues relating to socialism and a better understanding of socialism. You have written many articles on the a better understanding of socialism. I myself have penned quite a few. Recently, the Chinese Financial and Economic Press published my book *The Economy in the Initial Stage of Socialism in China*, a considerable part of which is devoted to none other than a better understanding of socialism. About 10 years ago, I pointed out that Chinese Marxists today must tackle a different set of problems from those in the era of democratic revolution. Marx, Engels, Lenin, and even Stalin had dwelt at length on the basic theory of national democratic revolution. We can say that there was a fundamental conclusion on broad themes. Our task then was to combine general Marxist principles with the actual conditions in China. Today, however, we have no choice but to further the general tenets of Marxism on our own and then combine whatever Marxist theories we have developed with the realities in this country. Consequently, as we study the initial stage of socialism in China, we cannot but examine the general principles of socialist societies.

Let me now say a word about some of the views of the socialist society that have come into currency recently. Not long ago Comrade Liu Shiding [0491 0013 1353] and I co-wrote a book entitled *A Better Understanding: A Topic of Our Times* for Hunan People's Press. We noted in the foreword that what we refer to today as a better understanding is not the usual re-thinking of an old topic but of the topic of a new era. We also pointed out in the concluding remarks that Marxism must be modernized. The book is about understanding socialism, capitalism, the economic and political situations in the modern world, and the relations between man and nature anew. We argued in our book that the contemporary socialist society is not the socialist-communist society that will materialize after the capitalist society in the sequence of human societies, a society whose economic and cultural levels are such that it is far beyond the reach of the capitalist society. No, the contemporary socialist society is the socialist society that must coexist, interact in many ways, compete, and engage in other forms of struggle with the capitalist society. We make this characteristic of the contemporary socialist society very clear when we call for outdoing capitalist societies in labor productivity and when we call for modernization.

Although this kind of socialist society does not come about because the advanced social productive forces in the country free it from the shackles of capitalism, its birth is inseparable from the larger trend in the development of human society from capitalism to socialism. It came about because of the breakdown in certain weak links in the capitalist world under specific historic circumstances at a time when capitalism is in decline. Also, we can see clearly that when capitalism is in the ascendant, it coexists only with relatively primitive forms of social economy. It is only when capitalism goes downhill that it is accompanied by our kind of new social economy. The coexistence of two basic forms of social economy can be considered a common phenomenon in human history. Such a coexistence can take one of two forms: the coexistence of two basic social production relations within one nation and the coexistence of two nations each with a different social economy. Both forms of coexistence can be regarded as a transition in the evolution of human history from a lower type of social economy to a higher form. Right now the coexistence between socialist societies and capitalist societies shows that human society is in the midst of a transition from capitalism to socialism. The term "transition" in this context refers to a "major transition," quite unlike the "period of transition" that we ordinarily talk about.

As long as it coexists with a capitalist society, the socialist society must interact with the latter in a variety of ways. Such interactions, however, differ as countries differ.

We can explain the existence of socialism in certain countries today by analyzing actual historical circumstances. The argument that socialism can develop only in relatively advanced capitalist nations has proved to be

wrong. Both the Soviet Union and China, the two largest socialist nations, (as well as many other socialist nations), were economically and culturally backward. It does not follow, of course, that socialism cannot take hold in an advanced capitalist nation. The Democratic Republic of Germany and Czechoslovakia, for example, were not backward capitalist nations before the revolution. Many of the problems in socialist societies today stem from the fact that they were underdeveloped nations to begin with.

Contemporary socialist societies have one other characteristic, namely that they all belong to the first batch of socialist societies that emerged from socialist revolution and the dictatorship of the proletariat. Moreover, all of them are in the middle of structural reform and policy adjustment. Successful reform will propel these societies to a new historical stage.

I believe that studying some of the basic concepts about socialist societies will help our research on the initial stage of socialism.

#### **Tong Dalin: Understanding the Socialist Ownership System Anew**

An important part of understanding socialism anew is reexamining the socialist ownership system.

Toward that end, we should first seek enlightenment from what Marx said in this context:

First, Marx wrote, "From the standpoint of a higher socio-economic formation, the private property of particular individuals in the earth will appear just as absurd as the private property of one man in other men. Even an entire society, a nation, or all simultaneously existing societies taken together, are not the owners of the earth. They are simply its possessors, its beneficiaries, and have to bequeath it in an improved state to succeeding generations."<sup>1</sup>

As I see it, what Marx meant to say was that not only land, but all natural resources, are the assets of all mankind and cannot be appropriated by anybody. But this kind of "social ownership" is attainable only in a relatively advanced social economy, that is, a socialist society. This kind of social ownership can be regarded as the basic form of socialist ownership.

Under the family contracting system in the countryside, land is merely made over to peasants for their use for a fixed number of years; the land itself does not become the property of the peasants. We also have been commercializing housing and creating a real estate market, among other things. But the land involved still belongs to society and is not for sale. What are being transferred and leased are utilization rights and management rights.

Second, after the Paris Commune was set up, it was assumed by some people that with localities establishing their own communes, the central government would become idle and might even be abolished. Rejecting this notion, Marx wrote, "Reserve for the central government a few but essential functions."

In other words: 1) The central government cannot be done away with; 2) It cannot handle too many things. Nor should it control everything or centralize everything in its hands. With its highly centralized command planning, our planned economy of the past was precisely a violation of this Marxist dictum; 3) It must be put in charge of the most critical things, delegating the less important ones to local authorities and enterprises.

Third, we are all familiar with the following passage from Marx: "Imagine an association of free individuals. They carry out labor using public means of production and conscientiously apply the labor power of many individuals as the labor power of one society..."

We used to think this represents the vision of a future communist society. As for what constitutes a free individual and an association of free individuals, economists have argued forever about them forever. Here I would like to discuss whether we should rephrase "free individuals" as "free laborers" and whether the myriad horizontal economic joint organizations that have been flourishing in the course of reform, that is, the assorted enterprises, groups of enterprises, corporations, and even multinational companies, can be considered "associations." I once referred to the miscellaneous economic joint organizations, particularly corporations, as "socialist common ownership." Now it seems that they also can be described as "socialist joint ownership."

A socialist enterprise is itself a form of "association of labor." This form of association is essentially an association of labor power. On the basis of the association of labor power, it can also be an association of technology, sales, marketing, and funds. Enterprises following the stockholding system where workers can buy shares, which have been emerging, are a kind of labor associations cum fund associations. Some of the socially owned and state-owned enterprises mentioned above would also become a form of joint enterprise.

What is noteworthy is that the large number of horizontal joint economic organizations, particularly groups of enterprises and corporations, will become an important form of socialist joint ownership (or common ownership).

Fourth, let us take a look at the last passage in Section 7 of Chapter 24, Volume 1 of "Das Kapital," which is as puzzling as an unsolved riddle: "Capitalist appropriation, which is suited to the capitalist mode of production, is the first negation of private ownership as the inevitable consequence of independent individual labor. However, capitalist production negates itself because of

the inevitability of natural changes. This negation does not refer to the restoration of private ownership by workers but to individual worker ownership on the basis of the achievements of the capitalist era, cooperation, and common appropriation of all means of production, including land."

I quote this passage to call attention to an important Marxist tenet, namely that individual worker ownership be reintroduced in a socialist society.

The most monumental achievement of economic structural reform in China, the rural family contracting system, along with all manner of business activities now engaged in by individual workers, constitute precisely a kind of "individual worker ownership," don't they? It seems that individual worker ownership can mean one of two things:—The worker himself has his own labor right and is free to use his labor skills. He can be hired (and dismissed) by any kind of enterprise, set up any form of enterprise with other workers, or strike out on his own.

—A worker is free to spend his various kinds of incomes (and pay taxes as required by law). He is free to save and buy stocks and bonds, etc.

Starting from some unknown point in time, our socialism has always regarded the notion of "individual" as taboo, as if "individual" means "private ownership." As for the expression "individual interests," we dare not even mention it. Socialist economic theory and practice too tries to avoid individual interests if at all possible as if individual interests and socialist tenets were completely mutually exclusive. In fact, what social interests can there be in the absence of individual interests? Social interests are the sum of individual interests.

The real significance of Marx's proposition that individual worker ownership be restored is that we must fully mobilize the initiative, enthusiasm, intelligence, and talent of individual workers so that society as a whole prospers and flourishes.

A socialist economy is exactly one where individual interests and social interests coincide. A most important ingredient of socialist ownership is individual worker ownership.

The four passages by Marx that I have quoted above constitute the outline and even the substance of socialist ownership:

Social ownership (eg., land); socialist state ownership; socialist joint ownership; and individual worker ownership.

In addition, to promote the rapid growth of social productive forces at the present stage of socialism, we should permit the presence and development of a private

economy with a definite capitalist element and enterprises funded by the three sources of capital in order to supplement the socialist economy.

As a form of micro-organization, the enterprise differs from one another in nature, depending on the way its ownership, appropriation, utilization right, operation and management right, and labor right are combined or separated. Under socialist ownership, an enterprise may take any form provided it is conducive to optimal economic efficiency. All enterprises should be treated equally without discrimination. Under no circumstances should we impose uniformity, let alone demand that everybody follow the same rules across the board.

In short, the structure of socialist ownership must be suited to the development of a social commodity economy. If the two dovetail, social productive forces will grow rapidly and the superiority of the socialist system will become more apparent.

#### **Lin Zili: New Experience in the Modern Commodity Economy and Understanding Socialism Anew**

There are two prerequisites for understanding socialism anew. First, a review of the new experience in the modern commodity economy and hence a new understanding of it. If we do not have this new understanding and continue to see the modern commodity economy through the traditional theory, we will not be able to explain scientifically the new concept of the socialist commodity economy, let alone truly understand socialism anew. Second, a review of the reform experience of socialist nations, particularly China, and hence a new understanding of the socialist theoretical model. Only thus can we intensify and systematize our new understanding of socialism.

The development and evolution of the world commodity economy from the commercialization of products, labor, and property rights to the formation of macroeconomic functions has been a long historical process. In the days before labor became a commodity, product commercialization had made hardly any progress. What prevailed then was still some kind of small commodity production. When labor became a commodity, it released a massive labor potential for full and sound utilization by society, tremendously boosting product commercialization and the development of a commodity economy. The result was the creation of an enormous amount of wealth unmatched by that in any era in the past. Labor commercialization, that is, full production socialization, is well suited to product commercialization. However, it conflicts with the closed nature of property ownership, resulting in the commercialization of ownership rights. Full commercialization of ownership rights, that is, property socialization, in turn enables all material resources to be fully and rationally utilized, leading to a

second liberation of productive forces. Property socialization, which is in keeping with production socialization, implies a comprehensive market system and suggests that the different types of incomes of members of society, such as labor wages and returns on capital and real estate, can all be expressed clearly on the market through labor prices, fund, and real estate prices, etc., thus creating the conditions for the government to regulate incomes and hence economic relations and operations, and even discharge its macroeconomic functions. For those of us who want to understand socialism anew, reviewing this historical process is highly enlightening.

Property socialization, which is compatible with labor commercialization, and the formation of macroeconomic functions signal that the commodity economy has entered a brand new stage, namely the stage of the modern commodity economy. The modern commodity economy not only has propelled productive forces to a new high, but has also simplified and clarified social economic relations as a result of the fact that the various different types of incomes of members of society can also be expressed clearly through the market. Coupled with the formation of macroeconomic functions, the modern commodity economy has greatly enhanced our ability to choose and control our own social relations. In other words, different nations and regions in the same commodity economic environment can choose different economic relations and different social systems. During the 19th and early 20th centuries, one might equate the commodity economy with capitalism. Today, however, this argument has lost all its persuasiveness. This is because through its own evolution, the commodity economy has transcended capitalism and outgrown the framework of capitalism. Labor commercialization used to be synonymous with capitalism. No longer. Today, it is perfectly possible for labor commercialization and the formation of a labor market to be the realization of such a basic principle as labor equality and pay equality. So-called labor equality means equal opportunity in employment, while so-called pay equality means that compensation is commensurate with labor. This is socialism, is it not? If property socialization was regarded as an infringement on ownership in the days when the traditional mode of socialism held sway, then today the closed variety of ownership right (whether private or public) not only is incompatible with production socialization, but also conflicts with socialist tenets. When ownership rights were closed, that is, when there was no commodity market, it was difficult to bring about equal opportunity in the utilization of social funds and resources, or to form macroeconomic functions to regulate different incomes, social economic relations, and economic operations, thereby complicating the realization of the principle of labor equality and pay equality.

These new experiences and characteristics of the modern commodity economy are immensely significant for our effort to understand socialism anew. The crystallization of the new experiences will become a part of the theoretical basis of the a better understanding of socialism.

This is because as an intrinsic part of the general commodity economy, they will also be applicable to the socialist commodity economy. Even as we created favorable conditions to nurture a product economy, we have, through intensive coordinated reform, speeded up labor commercialization and property socialization and developed socialist macroeconomic functions so that they can fully regulate incomes (particularly such new labor incomes as those derived from property ownership rights) and hence social economic relations. Thus we are fully capable of establishing a highly efficient new system and new order that satisfies the equality principle of socialism, on the one hand, and allows the market mechanism of the commodity economy to operate, on the other.

The difference between the socialist commodity economy and other commodity economies does not lie in the extent, magnitude, or intensity of commercialization. It differs from other commodity economies because it has different commodity economic relations or a different form of commodity economy. How to sum up these difference is also of great interest to people who want to understand socialism anew.

According to scientific socialism, socialism means abolishing the control and appropriation of labor by property (capital), liberating labor, establishing the exchange of equal amounts of labor, that is, production and distribution relations based on labor equality and pay equality. What gives an utopian touch to this kind of idealistic socialism is that it sees labor exchange and distribution as something that is direct and does not need to be effected through the market. That is impossible. Labor equality and pay equality themselves make it utopian. Based on the new experiences in and new characteristics of the modern commodity economy and through the string of coordinated and intensive reforms mentioned above, we are perfectly capable of achieving labor equality and pay equality along with efficiency in an indirect relative way through market mechanisms and by relying on socialist macroeconomic functions. This is also what we refer to as socialist commodity economic relations under which there are equal employment opportunity and equal opportunity to utilize social resources, and where pay is commensurate with labor and income is commensurate with contributions.

Some economists in socialist countries that have taken the lead in reform have put forward a number of new theoretical models defying traditional teaching. While different from one another, the models have one thing in common, namely that they all sum up the socialist economy as the relationship between planning and the market, that is, the planning-market model. The model has much to recommend itself. In our opinion, however, both the market and planning belong in the form of production and exchange, that is, a form of economic operations, and not economic system. Whatever the special form it may take, the modern commodity economy includes an element of planning. Such planning is

part of the government's macroeconomic function, which, however, is not confined to planning alone but embraces a broader and deeper area. In any case, whatever the relationship between planning and the market, it cannot explain the relationship between the commodity economy and socialism and hence resolve a better understanding of socialism. Second, based on the planning-market model, it seems that socialism may be a semi-commodity or semi-market economy with no markets for the two major elements of production, labor and property. But as we noted before, commodity economies do not differ in the extent or intensity of commercialization, but in commodity economic relations. The socialist commodity economy is a modern commodity economy. It needs a sound and complete market system. A semi-market state should exist only in the transition stage as the old system gives way to the new. It cannot be considered as the ultimate model. Some countries have been languishing for long periods in the quagmire of low growth accompanied by high inflation, with reform becoming a long-drawn-out tug-of-war between old and new institutions. This state of affairs has something to do with the shortcomings in the theoretical model. This is a lesson we must learn.

Generally speaking, the Chinese reform theory is different from the planning-market model. The CPC Central Committee has recognized the new concept of the socialist commodity economy, accepted a complete market system including a market for elements of production, endorsed the separation of management right from ownership right, and called for the establishment of a socialist commodity economy. To understand socialism anew necessarily means refining and systematizing the theory of the socialist commodity economy, which is different from the planning-market model.

The refinement and systematization of our new understanding of socialism will involve a string of fundamental theoretical issues. Besides the general theory of the modern commodity economy and socialism, they include the theory of the exchange of labor, the theory of property, income composition and its regulation, social economic organizational structure, and theories of macroeconomic and microeconomic operation, particularly the development of the theory of value. This is the only way to make sure that the a better understanding of socialism will rest on a solid theoretical foundation. In recent years, we have made significant headway in devising reform policies; a variety of policies and approaches have been unveiled. This has tremendous significance for the selection of reform strategic options. However, sophisticated in-depth systematic theoretical research on reform, including research on the theoretical framework for the socialist commodity economy and research on the objectives of reform, has been relatively scanty. If such research is not expanded correspondingly, policy-oriented research will not reach a high level for lack of the support of a basic theory.

The a better understanding of socialism must stem from a review of reform practice in China. This is the only way

to conform with the realities in the country. As noted above, we must review the new experience in the modern commodity economy. The purpose is to elevate understanding to a higher level and verify it in light of the general inevitability of the development of a commodity economy so that our understanding acquires the essence of a scientific theory and becomes more practically significant.

In China, price reform was proposed as early as 1984. Its intensification has been much delayed because of scarcity, that is, supply shortages created under the old system which also manifest themselves as a demand explosion. In times of acute shortages, a real market and reasonable prices cannot take shape. But the elimination of shortages itself demands a market that is already in place. This could well be the worst stumbling block to reform in China.

An in-depth examination and review of practice proves that: 1) The labor system must be reformed to turn labor into a commodity, form a labor market, introduce equal opportunity in employment, and make pay commensurate with work. This is the only way to raise labor productivity and expand effective supply promptly; 2) The property system must be reformed to socialize and commercialize ownership right. This is the only way to improve the efficiency with which funds and real estate are utilized; increase their effective supply rapidly, avoid the misuse, waste, and loss of social resources; and balance investment demand with investment supply; 3) It will be some time before the effects of labor and property rights reforms are fully felt. At present the emphasis should be on putting our economic house in order and cleaning up

The environment in order to set the stage for price decontrol and the formation of a product market; 4) Some measures in property right reform also serve the purpose of cleaning up the economic environment. Still, we must also employ administrative and legal tools, among others, to curb demand and check the loss of a massive amount of wealth in order to close the gap between aggregate supply and aggregate demand. But this situation cannot last long if the effects of labor and property rights reform do not become fully obvious. Therefore, only by coordinating price reform (which means straightening out the current environment) closely with labor reform and property rights reform can we steer reform onto the road to success. This also means turning the three consecutive historical processes—product commercialization, labor commercialization, and property socialization—into concurrent coordinated reforms under China's current conditions.

Labor reform and property rights reform belong in enterprise reform and represent a thorough-going reform in the enterprise system. At the same time, however, they nurture the markets of the two major elements of production. In addition, they demand that government function be strengthened. Thus it can be seen that

enterprise reform, market nurturing, and the development of macroeconomic functions are inseparable processes. Here the conclusion we draw from experience is consistent with what we have noted earlier about the general inevitability of the commodity economy, the only difference being one of procedure or sequence (which is dictated by the actual circumstances,) and is also compatible with the socialist theoretical model described above, and naturally so. Actually, to understand socialism anew is necessarily to understand inevitability and laws, that is, science. And the understanding of science must be in line with realities. In other words, it must be in line with practice.

### **Gong Yuzhi: Understanding Socialism Anew Comprehensively**

There has been much discussion in the theoretical community on understanding socialism anew. Programmatic documents of the 13th National Party Congress [NPC] convened last year formally put forward just such a mission. The mission demands that we understand socialism anew comprehensively in every aspect—economics, politics, culture, the basic task of socialism and its basic dynamics, stages in the development of socialism, the international environment and historical circumstances, among others.

The theory of the initial stage of socialism in China results in part from a better understanding of socialism. On the one hand, reform in China is based on realities in the country, its characteristics, and the fact that socialism in China is in the initial stage. On the other hand, it is based on our better understanding of the general tenets of socialism and our modernization of socialist concepts. The two are closely related.

When we say we want to build a socialism with Chinese characteristics, we mean that some of our old notions and ideals about socialism have become incompatible with China's circumstances. Maybe they suit other nations fine, but socialism in China must be consistent with Chinese circumstances and have Chinese characteristics.

When we say we must recognize that socialism in China is still in the initial stage, we mean that some of our previous notions and ideals about socialism have become incompatible with the present stage of socialist development in China. They may suit other countries where socialist development has advanced to a higher level, but socialism in China today must be compatible with the fact that it is still in the initial stage and must display the characteristics of such a stage.

What we are talking about here is characteristics and individuality. One is spatial and geographical; the other is temporal and has to do with stages of development. The two look at the same object from different angles.

For a long time to come, a most basic Chinese characteristic on the mainland will be the initial stage of socialism. (Another basic Chinese characteristic is the adoption of "one nation, two systems" throughout China.)

Individuality contains generality, and particularity contains commonality. The new concepts we acquire when we understand socialism anew by proceeding from realities in China and the initial stage may not be applicable to China and the initial stage alone. They will include things of general significance, new explorations, and new understanding of the general principles of scientific socialism. Their applicability will extend beyond the initial stage of socialism in this country.

To put it differently, some of our old notions and models about socialism are incompatible not only with the situation in China at the present stage, but also with the situation in foreign countries where socialism has attained a higher level of development. They were things in our past general understanding of socialism that have not been scientifically verified or that have proved to be unsuited to historical development. The new understanding of socialism we gain when we proceed from Chinese realities will provide a new basis for our further entry into a more advanced stage of socialism. On this new basis will our socialist theory develop and forge ahead in a way that is compatible with domestic and international conditions. It does not mean that the new understanding of socialism we will acquire when we discuss and examine the various practical and theoretical issues concerning the initial stage of socialism in China will be applicable only to China and only to the initial stage of socialism and that we should revert to the original notions of socialism as soon as socialism has outgrown the initial stage.

Fundamentally speaking, therefore, the a better understanding of socialism while China is in the initial stage of socialism is part of the continuous process of socialist practice and understanding and part of the ongoing development of socialist theory. It is not an expediency, a retreat, or a digression.

Understanding socialism anew must take place at the historical as well as theoretical levels. A better understanding of history can further our a better understanding of the theory of socialism, and vice versa.

To understand the history of socialism anew in China, the CPC has adopted the "Resolution on Certain Historical Issues of the Party Since the Founding of the People's Republic of China." Even as it analyzed the initial stage of socialism, the 13th NPC again reviewed the history of the development of socialism in China. This review was even more penetrating than the "Resolution."



To understand the history of socialism anew is to understand the history of other socialist nations anew as well, particularly the Soviet Union. The history of socialism in the Soviet Union is closely related to our embrace of socialism. Many of our traditional concepts about socialism were derived from "A Concise Course in the History of the All-Union Communist Party (Bolsheviks)." Today, the Soviet Union itself is trying to understand its history anew. The theoretical rectification of the dogmatic interpretation of socialism and its mistaken accretions must be accompanied by a new understanding of the history of socialism in the Soviet Union and China.

A better understanding of socialism must be combined with a better understanding of capitalism as well. As a stage in social development that emerges from, and is higher, than capitalism, socialism should inherit the achievements of the capitalist civilization as the basis for its own development. Modern history has developed in such a way that it has made a number of relatively underdeveloped nations, of which China, with its vast territory and huge population, is the most striking example, enter socialism ahead of their more advanced capitalist counterparts. Industrialization and the commodity economy are a stage in the development of social productive forces and socioeconomic development that cannot be skipped. Historically, this stage came about under capitalism. If China, which achieved socialism without going through the stage of full-blown capitalism, wants to fulfill the historic mission of industrialization and the commercialization and socialization of production, it must fully understand and use as reference how the mission was fulfilled under capitalism in history. Moreover, modern capitalism has spawned new developments in productive forces (the new industrial revolution and technological revolution) and attained new highs and conquered new territory in the commercialization and socialization of production. Today, as we seek to develop a commodity economy and establish a new order, including appropriate laws and regulations and administrative management, suited to the socialist commodity economy under socialism, an important approach is to study and use as our guide the experience of modern capitalist development and assimilate those fruits of civilization that reflect common principles governing the commercialization and socialization of production. We had little understanding of and sometimes even refused to understand that development in the past. Our traditional understanding of capitalism not only languished at specific isolated conclusions arrived at by classical writers decades and even 100 years ago in light of the conditions at the time, but was also colored by our own simplistic interpretation and accretions, both largely based on the small peasant economy in isolation from the historical stage of production commercialization and socialization. Only by liberating our ideas; facing up to the reality that socialism and capitalism coexist, interact, contend, and compete with each other in our times; and, through comparison, understanding correctly modern capitalism

anew in a way that is consistent with realities can we arrive at a new scientific understanding of what kind of socialism modern socialism should be.

A better understanding of capitalism and socialism through comparison should also include a comparison of China vis-a-vis the Third World. Many nations and regions in the Third World are pursuing modernization under capitalism. We too are a Third World nation, but we are modernizing under socialism. There is a fundamental institutional difference: they are capitalist, we are socialist. But between them and us is one similarity, namely that we are all trying to modernize amid economic and cultural backwardness, with the result that we will encounter many similar problems, which should be closely compared. To reunderstand capitalism should also include a better understanding of how several Third World nations and regions achieve modernization by taking the capitalist road. Involved here are the theory of the initial stage of socialism in China and development strategy research.

In short, a better understanding of socialism is an ideology-liberating process much more profound and much more demanding in terms of theoretical review than bringing order out of the chaos of the Cultural Revolution. The Cultural Revolution turned right into wrong, so our job was to return things to the original state. Comprehensive reform means far more than a return to normalcy. Instead, we must proceed from where we were originally and forge ahead with Marxism on the basis of practice. We must liberate our ideology and bring about major developments in socialist theory. Only thus will our socialist cause achieve great new victories.

#### **Zheng Bijian: Make Research on Interest Groups and Interest Organizations A Priority**

The present state and future direction of interest groups and interest organizations in society constitutes a basic and controversial issue that cannot be sidestepped in our intensifying research on the state of the nation in the initial stage of socialism. Whether it is the change from the old to the new systems, the maturing of unified market mechanisms, the strengthening of macroeconomic functions, "bureaucratic speculation," "bureaucratic racketeering," panic buying, or assorted social problems, in the final analysis they all reflect directly or indirectly the interests, psychology, and behavior of disparate interest groups and organizations in society as well as the conflicts among those groups and between special interests and the general interest. This is a major issue. We can neither generalize it nor have a vague idea about it.

In the course of comprehensive reform and socialist modernization, internal social interests in China have become diversified. The diversification of citizen interests within a framework of shared basic interests will be

the long-term trend, one which will also be highly unstable and fluid and marked by frequent changes and ups and downs. This requires that we face up to reality and work hard to understand and cope with new changes in interest relations at a deeper level between different groups of people by observing complexly-involved social phenomena closely, instead of adhering to some generalizations and formulas.

For instance, we often say that our society consists of three groups of people: workers, peasants and intellectuals. This is certainly true, but we must also see that within each group a process of differentiation has been going on and will continue to do so. Among the three groups, too, there have been all kinds of overlapping and infiltration.

For instance, it is often said that economic relations and a superstructure based on public ownership determine that people have identical basic interests. No doubt this is true, but we must also see that even publicly-owned economic units have different economic interests and may clash sharply with one another because they belong to different sectors, localities, or units. The same is true for socialist state organs.

For example, it is often said that while workers under socialism may hold different jobs, they enjoy the same amount of esteem. No doubt this is correct, but we must also see that precisely because of division of labor, which leads to disparate jobs, different economic benefits, and unequal social status, and because of the distinction between employed people and retirees, people have sharply different interests, status, behavior, and psychology. Such differences will only grow over time.

Take another example. It is often said that reform is the self-improvement of the socialist system. This too is true. But as reform becomes more and more thoroughgoing, it is increasingly clear to us that just as the old system spawned its vested interests, so too does the new system. Then there are the parvenu who owed their sudden riches to the loopholes that crop up in the coexistence between and transition from the old to the new systems. Therefore, we must further understand and find out which interests are consistent with socialist modernization and meet the demand of social stability and hence worthy of protection and development and which interests are unfavorable and even damaging to socialist modernization and social stability and should hence be curbed, suppressed, or legally sanctioned.

This raises a point: To further understand the actual conditions and moves of different interest groups and organizations, we need a complete set of multi-level and multi-dimensional analytical methods and criteria, and cannot rely on just one single formula or yardstick (eg., whether it is publicly- or privately-owned). In addition, we need a complete set of correct methods to resolve conflicts. Needless to say, we must never rehash the old stuff—"take class struggle as the key link"—and such

timeworn leftist practice of mounting a political campaign. Instead, we should adopt new methods suited to the actual circumstances and consistent with interest reconciliation under socialist modernization.

For instance, to reconcile conflicting interests between different enterprises and groups of enterprises, we should apply the market mechanism and promote fair competition. To reconcile conflicting interests between different localities and sectors and between the central government and local authorities, we should adopt such devices as the "common market" and "community." To reconcile conflicting interests between some workers, we should use the labor market, wage regulation, social security, and similar measures. And, to safeguard the general interest effectively, we should adopt macroeconomic regulation and enforce administrative and party discipline and the law of the land, so on and so forth. It should be emphasized in particular that it is critical that we uphold the four cardinal principles, utilize our political strengths, and unify the whole party ideologically and in action at this vital juncture when the old system gives way to the new.

The problem with so-called interest groups and interest organizations, in my opinion, is essentially a problem of the people's changing and conflicting interests in the midst of comprehensive reform and socialist modernization. In the final analysis, it is a problem of people. Only by coming to grips with the "people's" interests and their various psychologies and modes of conduct derived therefrom can we really tackle reform and modernization as a people's problem, a social problem, and a political problem, and accord it the importance due it. Only thus can we conscientiously deploy economic, administrative, legal, and educational tools to gradually create, consolidate, and develop a configuration of interest groups and interest organizations that genuinely satisfy the demands of socialist modernization and social stability in order to make our society highly dynamic as well as highly stable.

The economic history of the world has proved time and again that such "dynamism" and "stability" are a major issue that any modernizing nation and people, whatever its social system, will inevitably encounter. Today we have run into precisely the same problem. Comprehensive reform and modernization, it is said, constitute a major social upheaval in China, a new period of radical change within the framework of socialism. What does this upheaval consist of? Apparently not only a significant expansion of productive forces, an overhaul of the economic and political systems, and a major advance in the socialist spiritual civilization, but also a rational adjustment of interest groups and interest organizations.

As comprehensive reform and modernization get under way and the socialist commodity economy and socialist democratic politics take shape, the structure and pattern of interest groups and interest organizations will become more and more well-defined and Chinese society will

become more and more dynamic and stable. Can we say that the rational adjustment of interest groups and interest organizations should also become an important ingredient of the overall plan of socialist modernization in China, a key part of the country's economic and social development strategy in the initial stage of socialism?

**Gui Shiyong: The Development Level of the Commodity Economy Should Match That of Social Productive Forces**

As I see it, what lies at the heart of the theory of the initial stage of socialism is the commodity economy. The modernization of production must go hand in hand with its commercialization and socialization. To develop productive forces, we must promote commercialization, even under socialism. In turn, the progress of commercialization must be compatible with the extent to which productive forces have developed. We must go all out to commercialize precisely because of China's current backwardness in productive forces. This is the only way to expedite the development of productive forces.

In the past, commercialization was criticized and rejected. The commodity economy was equated with capitalism. Clearly this was wrong. But we must see that the development of a commodity economy is conditional upon the developmental level of productive forces as well as the relations of production. The scale, scope, and form of a commodity economy may vary with the developmental level of productive forces. For instance, the formation of a unified market depends on social specialization and a strong transportation industry. The development of a market for elements of production depends on the maturing of a commodity economy, so on and so forth. We can accelerate the development of productive forces only by selecting a specific development mode for the commodity economy in light of the actual developmental level and demand of productive forces. To do otherwise—proceed from an abstract idealized model or simply copy a foreign model—that is, to skip a stage temporarily and impose uniformity spatially, would often be counterproductive.

I think we have set the right goal for our socialist planned commodity economy. But to achieve this goal, I am afraid, will take a long-term effort consisting of many transitional stages. Right now, what we do not have enough of is hard thinking about the transitional stages that we must pass through before reaching our final goal and the forms such transitions must take. Each front, each industry has set its own goal and, having done that, is wasting no time to pursue it. But what about the synergistic results of their actions? Will they be compatible with the level of the current productive forces? Can they resolve the array of problems in our economic life today? These questions are not being answered in a comprehensive and coordinated way. The upshot of this kind of joint effort may well prove unfavorable to the healthy development of reform as a whole and may even

destabilize the economy. As a mammoth piece of systems engineering, reform should proceed under good leadership in an orderly manner. To proceed in a way that conforms with economic and social realities. If investment has priorities, so must reform. Indeed, our reform priorities must be closely related to the drive to solve current economic problems. When the economy has taken off, new conflicts of higher order will appear, making necessary a new set of reform priorities. To me, so-called coordinated reform does not mean a stampede in which everybody rushes headlong into reform at the same time, but organic coordination and cooperation.

The experience of history proves that to develop productive forces, achieve modernization, and overtake economically developed nations, an economically backward country must satisfy three conditions: 1) put up with a relatively low standard of living; 2) work hard even as it puts up with a low living standard; and 3) utilize advanced foreign technology and experiences. When the Japanese were trying to overtake the Americans, they worked 10 hours and more a day even though their living standards were much lower. At the same time, they made the import of advanced American technology a priority. Watching the Japanese close in step by step and competing for markets with themselves, some Americans then criticized Japan's "Bushido spirit." Today a number of Japanese feel the same about South Korea. As we play the catch-up game, we must also create such a climate and such a mechanism. Our reform should help put together such a mechanism promptly.

**Wang Jue: The Difference in Principle Between Modern Democratic Socialism and Communist Socialism**

As a social system in human society, socialism has now had a history of over 70 years. Its emergence and development conforms with the general law of the development of human society and represents a vital force. However, we must also see that while the socialist countries today each have their strong points in development, none of them is ideal, generally speaking. Whether we are talking about the development of the spiritual civilization or material civilization or political democratization, there have been many setbacks, a high price has been paid, and at times these countries seem to be stagnating. This fact cannot but cause all people concerned about the destiny of the socialist system to think long and hard. Thus the call for a better understanding of socialism or understanding socialism anew must be considered a good idea. I believe we must clarify the following points on a theoretical level if we are to understand socialism anew:

First, modern socialism should not be the socialism envisioned by Marx for the initial stage of communism. After analyzing the internal conflicts of the capitalist economy and its law of development, Marx came up with the objective law that capitalism would inevitably

be replaced by communism. Later, he divided communism into an initial stage and advanced stage. Lenin called the initial stage socialism. In its original meaning, therefore, socialism refers to that stage in the development of human society that is higher than capitalism. We can call this kind of socialism communist socialism. Communist socialism is the new social system that emerges under capitalism when productive forces have become so highly developed that they cannot be accommodated within capitalist relations of production. The salient economic characteristics of this socialist system, as expounded by Marx, are the social ownership of means of production, the transformation of individual labor into direct social labor, the distribution of means of consumption according to labor, and direct social or state planning of the entire social production process. This is Marx's scientific prophecy, a social system superior to capitalism that is bound to appear in human society. Capitalism cannot "exist forever"; a day will come when it is replaced by communism. So far, however, capitalism has not advanced to a stage at which it can be replaced by communism. It follows that the socialism in existence today is not at all the kind of socialism brought to light by Marx. It is merely a democratic socialist system that may come about amid unique historical circumstances in the development of capitalism that is yet different from capitalism. In other words, it is born at that special stage when capitalism has not matured fully. For that reason, feudalism remains a major influence in its politics, economics, culture, and other areas. Thus a vital mission in the establishment and growth of socialism is the introduction of democratic politics and resistance of feudalism. Accordingly, we may characterize this variety of socialism as democratic socialism. As different stages in the evolution of human society, it differs in principle from the communist socialism promulgated by Marx.

Traditionally we have overlooked such differences and arbitrarily turned the basic principles of Marx's communist socialism into a rigid mold to shape present-day socialism in an attempt to finish in the democratic socialist period what should be done under communist socialism. No wonder we were bedeviled by "leftist" errors for years. It is time we wake up.

Second, the "leftist" error of shaping modern socialism in the image of communist socialism was epitomized by our effort to curb and destroy the commodity economy. As noted before, present-day socialism was born midway through or even in a very elementary stage of capitalism. That is, it was born in that historical stage when human society was moving from a natural economy to a commodity economy. Hence the basic route for the development of democratic socialism can only be to follow commodity economy, instead of sidestepping it. From the perspective of history, it is precisely because it chose the commodity economy, which satisfies the requirement of the development of productive forces, over the natural economy that modern capitalism has been able

to commercialize, socialize, and modernize social productive forces, with the result that such forces have grown rapidly. As for the capitalist class, it has reaped the benefits of this system and turned itself into a group of billionaires. Democratic socialism, in contrast, ignored the basic rationale for the commodity economy, namely the objective reality of the continuing conflict between individual labor and social labor. Determined to deviate from the commodity economy, which is the correct way to develop productive forces, it took as its goal communist socialism, which has no place for the commodity economy. The upshot is longstanding economic stagnation in and impoverishment of democratic socialist societies. Now we have no choice but to understand modern socialism anew. The democratic socialist economy must be a commodity economy. We must make a major effort to develop the commodity economy and achieve the commercialization, socialization, and modernization of production. This is the only way to prepare the ground for the transformation of democratic socialism into communist socialism in the future.

Third, democratic socialism in China is still at an elementary stage. The development of productive forces is still at a very low level. The economy as a whole remains a dual economy—a small production economy in the countryside coexisting with a large production economy in the cities. The commodity economy is primitive. No unified market has yet taken shape. The majority of workers are of a low educational and technical standard. This determines that the Chinese economy in the initial stage of democratic socialism can only be one dominated by socialism and supplemented by capitalism. Not only should we refrain from destroying capitalism, but we must encourage its development provided that the dominance of the socialist economy is not impaired. From the perspective of development, moreover, we should merge the socialist economy with the capitalist economy and enable them to grow together through the stockholding system in order to industrialize democratic socialism and commercialize, socialize, and modernize production, thereby creating the conditions for the transition to communist socialism in the future.

To sum up, we should differentiate between the communist socialism as described by Marx and the democratic socialism of today in order to avoid the setbacks and errors that may result from confusing the social systems in two different historical stages. That way we can also restore the reputation of Marxism and socialism. This will be our major reward for understanding socialism anew. Of course, this is a critical issue that needs to be further looked into and researched meticulously.

#### **Jia Chunfeng: To Study Social Conflicts, We Must Study Interest Relations**

I am all for GAIGE magazine holding a seminar on the theory of the initial stage of socialism and a better understanding of socialism. This is a well-chosen topic. Affirming that our society is in the initial stage of

socialism, that we must bring about the commercialization, socialization, and modernization of production, and that we must replace a predominantly natural or semi-natural economy with a highly developed commodity economy is a major achievement of our better understanding of socialism. And if we want to continue to refine the theory of the initial stage of socialism, we must come to grips with the basic issue of a better understanding of socialism. Clearly the development of the theory of the initial stage of socialism is closely interwoven with the refinement and intensification of socialism.

To "refine" and "intensify," we must launch scientific and creative theoretical research on a string of important topics. In my opinion, interest groups and social conflicts in the initial stage, for example, constitute a theoretical and practical topic of fundamental significance. In the past, we have done little systematic research in this area. There is a wide gap between what meager research we have in this area and the progress in real life and the demand of practice.

How then should we intensify our research in this area? Let me make a couple of points so that we can discuss them:

1. To study social conflicts, we must study interest relations and interest groups. Nowadays, we all recognize that conflicting interests remain among various interest groups under socialism. This is a reality that exists objectively and subjectively. Many social conflicts must be resolved through reform or in the course of reform. But inevitably new interest adjustments and conflicts will occur in the course of reform. If we can study and analyze in earnest the adjustment of the tangible interests of the public in the course of economic reform, the dissolution of interest groups, and conflict resolution among different interest groups, it would contribute immensely to conflict resolution in the midst of reform and opening to the outside world and help ensure that modernization can take place in a socially stable environment.

2. Changes in social interest relations and interest groups will inevitably lead to changes in social psychology. Thus anybody who studies social conflicts in the initial stage must also study changes in social psychology and social thinking. Since our economic life is in a transition from a natural or semi-natural, highly-centralized and planned economy to a socialist commodity economy, and since the industrial structure as well as social structure are undergoing changes, public thinking and ideas will necessarily change as well. Changes are often accompanied by endless discussions and diverse trends of thought. Thus we must integrate the research on interest relations, interest groups, social structure, and social conflicts with that on social psychological trends and conduct comprehensive research. Only thus can we get a handle on the confusing maze of social conflicts in the "initial stage,"

understand their nature, type, form, manifestations, level, and developmental trend, and work out a variety of methods and approaches to resolve these conflicts properly and successfully.

3. Research on interest groups and social conflicts in the "initial stage" is a highly scientific theoretical task. As such it should be based on research on the national conditions. Since the Central Committee of CPC put forward the task of intensifying research on the theory of the initial stage of socialism this year, some social science research institutions and theoretical educational organizations have stepped up research on interest groups and social conflicts as part of their research on national conditions. In addition, the liaison group on research of the theory of the initial stage of socialism proposes to organize seminars, exchanges, and discussions on this topic at the appropriate time. As I see it, such research has tremendous practical significance; at stake are the application and development of scientific socialism and historical materialism in the innovative practice of present-day China. As such, it merits a strong concerted effort on our part to study and explore it under the guidance of the methodology of the Marxist world outlook.

#### Wu Guoguang: On the Cultural Soil of Socialism

The word "soil" here is both a cliché and a metaphor. Actually what it means is this: Under what historical and cultural conditions can socialism thrive? Under what historical and cultural conditions did socialism emerge in China? What does the unique prescriptive nature of these conditions portend for China's socialist practice and understanding? Marx said man cannot create history freely as he pleases, but must do so under historically defined conditions. He and Engels wrote in "The German Ideology," the classic which founded historical materialism, "...at each stage there is found a material result: a sum of productive forces, a historically created relation of individuals to nature and to one another, which is handed down to each generation from its predecessor; a mass of productive forces, capital funds and conditions, which, on the one hand, is indeed modified by the new generation, but also on the other prescribes for it its conditions of life and gives it a definite development, a special character."<sup>2</sup> We are now raising this point based on Marxist tenets and in keeping with Marxist methodology. As for the historical conditions under which Chinese socialism was born, the report to the 13th NPC gave a rather detailed account when it put forward the theory of the initial stage of socialism. We raise the issues about "cultural conditions" and "cultural soil" here in the belief that if we sort them out, it would help us understand socialism and the theory of the initial stage of socialism.

Socialism is the fruit of the development of human civilization and appears at a particular stage in the course of such development. This is true on both practical and theoretical levels. Clearly, socialism is not born

in a vacuum but emerges only in a specific cultural milieu. According to the scientific analysis of Marx and Engels, it comes about only when the capitalist civilization has lost its vitality, inheriting the fruits of capitalism while rejecting capitalism itself. In other words, from the perspective of cultural soil and cultural conditions, socialism germinates and grows in the soil of capitalism. A highly developed capitalism nurtures the development of productive forces, which in turn results in a high level of cultural development, including the flowering of science, technology, and various branches of the humanities, from cultural refinement to moral standards, from cultural facilities to value systems. All of that constitutes the cultural framework for socialism. Socialism does not reject these cultural achievements lock, stock, and barrel. In fact, it can grow only in this kind of cultural soil.

Chinese socialism appeared under special historical circumstances. Similarly the cultural conditions in which it finds itself and its cultural soil are also different from what Marx and Engels envisioned, not a highly-developed post-capitalist culture, but a pre-capitalist culture. In terms of content, the pre-capitalist culture is reactionary and is suited to the natural economy and the small peasant economy. In terms of level, it is a low culture suited to backward productive forces. Building socialism on this kind of cultural basis presents special problems. Herein lies the crux of the cultural issue of the initial stage of socialism.

Some people say, "We have a glorious cultural tradition going back 5,000 years. How can you say our cultural basis is backward, reactionary, and of a low level?" These people forget at least one thing, namely that during our new democratic revolution and our struggle to bring about socialism, we were faced with a feudal culture. Weren't our own revolutionaries themselves deprived of the opportunity to learn culture? Did they not suffer for years under feudal oppression? In terms of value orientations, the traditional culture was the enemy of the socialist revolution. In terms of developmental level, the traditional culture was one under which a minority of people monopolized knowledge. In the course of historical development, both problems were resolved through the full-blown development of capitalism. In China, which skipped the full-blown development of capitalism, history has bequeathed to us these cultural problems: on the one hand, we must quickly improve the entire nation's scientific and cultural standards. On the other hand, we must rely on highly-developed productive forces. Yet the development of productive forces itself depends on all these things. It will be an uphill fight to break this vicious circle. We all know one saying by Lenin: "Communism cannot be built in a nation full of illiterates." We have made a herculean effort to raise the cultural level of the entire nation since the People's Republic was founded, with some success. Although the task is a daunting one and educational standards remain very low, at least more and more people now recognize the seriousness and importance of this matter. Turning to value orientation, we

still do not seem to be introspective enough. Criticize traditional culture and some people would right away condemn you for being "too radical," "renouncing your forefathers," and "being unpatriotic."

A discussion has been going on for about 100 years on the nature of the traditional Chinese culture. There have been many schools of thought. In 1940, Comrade Mao Zedong made this judgment in the famous treatise "A New Theory of Democracy," which he penned for the first issue of ZHONGGUO WENHUA. He wrote, "What were the so-called old politics and old economy of the Chinese nation? What were the so-called old culture of the Chinese nation? China has been a feudal society since the Zhou and Han Dynasties. Its politics was feudal politics. Its economy was a feudal economy. As for its reigning culture, which reflected this kind of politics and economy, it was a feudal culture. When foreign imperialism began invading China, capitalist elements gradually started to develop in the nation. Soon China became a colonial, semi-colonial, and semi-feudal society... The politics of this society is colonial, semi-colonial, and semi-feudal politics. Its economy is a colonial, semi-colonial, and semi-feudal economy. Reflecting the dominance of this kind of politics and economy is a colonial, semi-colonial, and semi-feudal culture." Comrade Mao Zedong noted bluntly, "These ruling politics, economy and culture are exactly the targets of our revolution. What we must eradicate is a kind of old colonial, semi-colonial, and semi-feudal politics, economy, and the culture that serves them."

I took the trouble to quote this exposition at length because I am bothered by this great mystery: Why does something which was so obvious half a century ago still bewilder some communists, including those who have taken up reform as their cause? Actually they are not really bewildered. It is just that some people insist that the traditional culture, which they consider a rallying point for the nation, be propagated. Any attempt to examine and criticize the traditional culture is considered a heresy. All proposals that we study the Western civilization are readily branded as "bourgeois liberalization." Is our socialism really closer to feudalism or capitalism? Which choice would be more backward, more reactionary? It would take just a little understanding of history and Marxism to see the light.

Certainly, the brutal fact is that our socialist society was born out of a struggle with the feudal tradition and that our cultural soil is precisely the soil of feudalism. There was no capitalism before us to lay a culturally advanced social foundation with modern values. Not only that, but we were under the yoke of feudalism both physically and psychologically. With feudalism casting a shadow over us subjectively and objectively, we had trouble understanding socialism correctly or practicing socialism without too many setbacks. In fact, what we traditionally understood as socialism could not but be colored by our own feudal background and hence took on a heavy streak of feudalism. Many socialist theories have undergone a

mutation and became heavily tinged with feudalism in the course of practice in the Chinese environment, which is steeped in feudal culture. The specter of feudalism, namely culture, often reincarnates itself in the guise of many newborn things or attaches itself to other things. Not only does it appear in the garb of socialism, but it has also become an accretion to the commodity economy in recent years as the commodity economy takes shape. Needless to say, the worst thing is to have the feudal culture reappear in the guise of socialism, which will greatly damage and jeopardize socialism. North of the Chang Jiang, a tangerine becomes a trifoliate orange. Socialism too has a problem of acclimatization. This is not to say that socialism is not suited to the conditions of China, only that in the course of adapting socialism to China and making it take root here, we must fully understand that our original cultural soil is highly hazardous to socialism. If we fail to combat feudalism in earnest in the areas of culture and ideology and work

hard to remove the feudal soil, then the cause of socialism will not triumph in China. The proposal of the theory of the initial stage of socialism results from clearly understanding China's national conditions. It provides us with a historical signpost to guide us in clearly understanding the growing and maturing process of socialism in China. We raise the issue of the cultural soil of socialism because we need to reexamine our understanding of socialism in terms of cultural background, dispel misconceptions, and make socialism scientific again. It is no accident that the cultural issue is getting more and more attention from the ideological community as we practice socialism and that the traditional culture has become a theoretical hot topic in the modernization process.

#### Footnotes

1. *Das Kapital*, Vol 3, Part 2, Chapter 46
2. *Selected Works of Marx and Engels*, Vol 1, p 43

## NATIONAL AFFAIRS, POLICY

### Zhou Xiaochuan on Need To Overhaul Value-Added Tax System

40060128 Beijing GUOJI MAOYI [INTERTRADE]  
in Chinese No 9, 27 Sep; No 10, 27 Oct 88

[Article by Zhou Xiaochuan 6650 1420 1557 and Yang Jianhua 2799 1696 5478: "The Introduction of Value-Added Tax Is an Important Step in the Structural Reform of the Economy as a Whole"]

[27 Sep 88 pp 7-12]

#### [Text] I. What Is Value-Added Tax?

##### A. Development of Value-Added Tax

Value-added tax is a new category of circulation tax that has developed after World War II. It was first suggested in the 1920's by a German businessman named Siemens. In 1954, France became the first country to introduce this tax system. In the 1960's and 1970's, many Western European, African, American, and Asian countries followed suit. Now, more than 40 countries and areas in the world have adopted it. Many more countries, including the United States, Japan, and some developing countries, are actively planning to reform their tax systems in this direction.

##### B. The Necessity To Reform the Traditional Circulation Tax System

Before introducing the value-added tax, all the countries have collected other forms of circulation taxes (or indirect taxes) such as excise tax, sales tax, product tax, industrial and commercial tax, business tax, and so forth. These traditional circulation taxes may have different names, but they have one common characteristic: They are collected on the full amount of the sales or business volume of the operating units in every production and circulation link.

These traditional ways of taxation objectively encourage the backward "big and all-inclusive" and "small but all-inclusive" forms of production and penalize production characterized by specialization and cooperation. The same kind of products may be taxed at different rates, depending on whether they are produced by an all-inclusive factory or cooperating factories. Goods and roughly processed items produced by all-inclusive factories are subject to lighter taxation because there are fewer production and circulation links. Goods and intensively processed items turned out by cooperating factories are more heavily taxed because they involve more production and circulation links. This is because the more intensively processed products have a greater need for socialized and coordinated production, require more parts and components purchased or imported from outside sources, involve more production and circulation links, are taxed more times, and end up with a heavier tax burden. By giving unequal treatment to roughly

processed products and intensively processed ones, the traditional circulation taxes hinder the development of socialized and coordinated production, the optimum allocation of resources, and the improvement of overall economic performance. At the same time, they hamper the formation and development of commercial outlets along more specialized lines, are not conducive to the implementation of a more clear and open export tax rebate policy, tend to subject export goods to repeated taxation, and put our own goods at a disadvantage in the international market. They are especially discriminatory against the multiple-linked intensively processed export products. In contrast, under the traditional circulation tax system, imported goods are taxed only once. As a result, some imported goods pay much lower taxes than similar domestic products, which is not only discriminatory against legitimate domestic production of import substitutes, but result in lost tax revenues. Moreover, because the traditional circulation taxes are not as open, fair, and reasonable as they should be, they not only fail to guarantee steady and reliable tax revenues for the state, but hinder the rationalization of domestic consumption pattern and production structure.

With the rapid development of large-scale socialized production, the number of operating links from production to marketing to consumption are also increasing. It is obvious that the circulation taxes, collected repeatedly as the number of operating links increases with specialization, are falling farther and farther behind the objective requirements of economic development.

Large-scale socialized production objectively requires the following:

1. The backward "large and all-inclusive" and "small but all-inclusive" forms of production must be replaced by production characterized by specialization and cooperation and organized on an extensive scale.
2. The simple and direct form of sales must be replaced by well-developed commercial circulation networks, and conditions must be created for similar or different products to compete on equal terms.
3. We must make our products competitive on equal terms in the international market, and we must rationalize the structure of our imports and exports.
4. Greater efforts must be made to insure the stability and reliability of our state revenues.
5. We must speed up the rationalization of our domestic consumption pattern and production structure.

These are also the objective conditions under which the reform of the traditional circulation taxes and the introduction of the value-added tax become necessary.



### C. Major Value-Added Tax Collection Practices

The following are major practices for the collection of value-added tax in various countries.

1. **Scope of collection:** Value-added tax is collected most extensively in Western European countries. The tax is collected in every link of agricultural, industrial, marketing, service, and other economic activities. Tax computation is based on the volume of commodity exchange (sales), the volume of noncommodity exchange (value of services and volume of business), the value of one's own consumption (nonbusiness consumption and nondeductible expenditures), and the value of imported goods (value declared at the customs). The scope of collection differs among the developing countries. Most of these countries follow the example of Western European countries (but agriculture is exempt); some of them tax industrial production and marketing, but not services; and a few of them tax only the manufacturing industry.

2. **Tax rates:** In most countries, the value-added tax rates are very simple with only two or three brackets. Usually there are three rate brackets: (1) Basic rate—generally between 10 percent and 20 percent, the most widely used, applicable to almost all manufactured goods. (2) Low rate—generally between 5 percent and 10 percent, applicable mainly to agricultural, forestry, and fishery products and foodstuffs, and sometimes also applied to the income of cultural, art, medical, public health, and other professional workers. (3) High rate (not in countries with only two brackets)—generally about 30 percent, applicable mainly to hobby and luxury items including gold and silver ornaments, pearls, and jewels. In the past few years, some Western European countries have also included electronics products in the high rate bracket in the face of massive imports from Japan.

3. **Tax computation:** Value-added tax is computed by an indirect method, that is, by the deduction of previously paid taxes. This is the major difference that sets value-added tax apart from past circulation taxes. After the deduction, the actual amount of tax paid in each production or circulation link is based on the value added in that link. The term added value refers to the net value of exchange (sales or business volume) in each link, which does not include the value exchanged or tax paid previously. However, the taxation of the added value is the result, and not how value-added tax is computed. The method used in actual computation is not to determine first the added value (sales minus cost of materials purchased, for example) and then the tax due, but to first calculate the gross tax on total sales or business volume and then the tax actually due by deducting previously paid taxes. The formula follows:

Tax due = value exchanged x tax rate - previously paid taxes

It is obvious that cost does not figure directly in this formula, but cost records are needed as proof of past tax payments. There are two other features in value-added tax computation. (1) Most Western European countries treat the tax as a separate amount from prices. The advantage of this practice is that by separating the tax from prices, the amount of tax payment in addition to the prices is clearly seen, open to public supervision, and easy to be deducted, transferred, refunded on exports, and reimposed on imports. (2) They have a strict invoice system, which is indispensable for the proper collection of the value-added tax. Tax computation, deduction of previously paid taxes, refunds, and exemptions must all be based on invoices. Taxes paid previously are specifically listed on purchase invoices, which are indispensable for deductions in each production and circulation link. As the basis for deductions, the invoices have brought the enterprises into a mutually checking relationship, which has a profound impact on their economic accounting.

4. **Refunds and exemptions:** Value-added tax can be reimbursed or exempted totally or partially. Total reimbursement or exemption means that in addition to reimbursement or exemption of tax for the present link, all previously paid taxes can also be deducted, and it is applicable to export goods, processing of materials supplied by foreign firms, transit goods, etc. Partial refund or exemption means that only the current tax can be refunded or exempted and that previously paid taxes are not deductible, and it is applicable to the postal, banking, cultural, sports, and other service trades.

### D. Advantages of Value-Added Tax

1. It promotes the development of specialized production. Different from traditional circulation taxes, which are imposed on the full value of the sales (or business volume) of enterprises, value-added tax is collected only on the added value of the sales (or business volume). Thus, the same tax is levied on the same kind of products without regard to the percentage of parts made by cooperating factories or purchased elsewhere, the degree of intensive processing, and the number of production and circulation links. It changes the irrational phenomenon of all-inclusive factories paying less taxes than cooperating factories and creates favorable conditions for the development of specialization and intensive processing. It also lowers the prices of intensively processed products, increases the demand for intensively processed products, and accelerates the structural change of industry.

2. It promotes the circulation of goods and services. Because the tax burden on goods and services is no longer affected by the number of circulation links, and increased number of circulation links no longer causes repeated taxation and heavier tax burden, the value-added tax will contribute to the development of commercial and service networks, stimulate the expansion of markets, and accelerate circulation and consumption.

Therefore, many countries have extended the collection of value-added taxes from production to all the circulation links of goods and services.

3. It helps "encourage export and restrict import," stimulates the growth of foreign trade, and protects domestic production. On exports, because previously paid taxes, clearly listed in the purchase invoices, are deductible, the cumulative total of value-added taxes paid is equal to the gross tax for the last circulation link before deductions. Therefore, by reimbursing the last link's gross tax to the production enterprises at the time of export, the goods can be sold in the international market at untaxed net sales prices (input cost + component cost) to compete with foreign goods on equal tax terms. On imports, the value-added tax plays a role in protecting domestic production from discrimination and safeguarding national economic rights and interests. The collection of value-added tax on imported goods is to give imports the same nondiscriminatory tax treatment, that is, to be taxed the same way domestic products are taxed. This will put an end to the phenomenon of the traditional product tax, which gives preferential treatment to imported goods (taxed at nominal rates) and discriminates against domestic products (taxed repeatedly at progressively higher rates). Moreover, as export tax refunds will "encourage exports," the reimposition of value-added taxes on imported goods obviously will "restrict imports." However, this kind of "restriction" is not discriminatory. Rather it is an "equal treatment without discrimination" for both imported and domestic products.

4. It helps insure the collection of state revenues in a universal, timely, steady, and reasonable manner and contributes to the "neutral" regulation of the economy. Value-added tax is collected on the added value of any and all business activities. It maintains and expands the range of universal taxation, insures the timeliness of collections, and thereby guarantees the stability of the state's tax revenue sources. At the same time, by solving the problem of repeated and progressively increasing taxation, it increases the fairness of the tax system and enables the state to regulate the economy without discrimination or partiality.

#### **E. Relationship With Other Consumption Taxes**

While collecting value-added taxes on a universal basis, some countries also impose consumption taxes on specific commodities (for example, tobacco, liquor, gold, silver, beverages, etc.). Where consumption taxes are collected differs from commodity to commodity, some are taxed in the production links, others in the circulation links. Consumption tax rates are generally high. The purpose in collecting consumption taxes is to use the high taxes to regulate and restrict the consumption of specific commodities, and to increase and expand the sources of revenues through the collection of high taxes

on high consumption. Consumption taxes are collected only on a few final products, and not on intermediate products. Therefore, they are usually not deductible.

## **II. The Great Significance of Value-Added Tax to Economic Reform**

The collection of value-added tax is not only universally applicable, but of great practical significance to China's current economic reform.

### **A. Promoting Lateral Economic Ties and Independent Enterprise Management**

The value-added tax, which cannot be collected repeatedly, contributes to the development of specialization and cooperation and the growth of all types of lateral economic associations. The local authorities, who would block lateral economic associations and specialization and division of labor for tax reasons under the system of dividing revenue and expenditure between the central and local governments, now have no reason to do so. The value-added tax system makes taxation of enterprises in every production and circulation link clear and reasonable, which will help the enterprises in independent accounting and management, contribute to the formation, development, and improvement of markets, make the enterprises directly oriented to domestic and foreign markets and to the public, and help build up the enterprises' vigor and vitality.

### **B. Strengthening Financial Restraint and Cost Accounting of Enterprises**

Thorough implementation of the value-added tax can stop many financial and tax loopholes, make the enterprises strengthen economic cost accounting, increase financial self-restraint, and strictly control nonbusiness expenditures and other corrupt practices. In the developing countries, including western countries which were once in the developing stage, an enterprise often has two or three sets of account books at the same time. In addition to its own internal books, there are books specially made for the tax department and other supervisory and control agencies to evade taxation and guard against an audit. The situation is caused mainly by the lack of clearly defined, loophole-free, open, and unified tax standards and regulations. With the introduction of the value-added tax, this phenomenon can be basically stopped. It is because the deduction of previously paid taxes in computing value-added tax (deduction method for short) requires a strict invoice system, and the system of tax deduction based on invoices requires that the enterprises save the invoices for all business expenditures (including materials used and labor cost for materials purchased from outside sources) for tax computation and as proof in calculating production costs. At the same time, because value-added tax is universally applied, the purchase invoices are equally important to all enterprises, and no enterprise will sell its invoices. Thus, it will no longer be possible for any enterprise to keep two or three sets of books. Under a strict invoice

system, if two sets of books appear, one of them is bound to fail the invoice test, which is obviously illegal and subject to heavy penalties. Moreover, if the industrial and commercial administrations have a different set of rules governing invoices for dinner parties, end-use consumer goods, and other nonbusiness expenditures, the enterprises will have no way to include these nonbusiness expenditures in their operating costs as they wish, and it will be easier to check whether an enterprise is lying about operating costs, falsifying workers' welfare expenses, or engaged in other forms of malpractice. Therefore, the implementation of an invoice system together with the value-added tax will be very helpful in solving the widespread problem of keeping two sets of books and unjustified additions to production costs and in strengthening the enterprises' financial restraint and cost accounting.

### C. Conducive to Rationalization of Production Structure

Because the tax rates on "added value" are rather uniform, there is no special encouragement for or discrimination against any product. All trades and products are taxed for added value at the same rates. The tax has no subjective partiality for any particular industry. It does not make some trades and products more profitable than others. Therefore, it represents a neutral production policy. This means that the production structure should be rationalized through market competition and that the force of the market mechanism should be brought to bear on the direction of production. Because differences in tax treatment for different industries cease to be a factor in commodity prices, the rationalization of prices must be achieved through market competition. After the supply-and-demand situation is reflected by prices, industries which command higher prices and therefore greater profits will attract more enterprises, and when production is pushed up by competition, prices will come down. It must be stressed that the neutral production policy represented by the value-added tax works only in coordination with price rationalization and market regulation. Government administrators and planners can only give limited guidance to future production structure through investment. Existing price distortions, however, need to be corrected by appropriate product taxes, and the so-called production policy is just an attempt to guide the way the price distortions are being corrected.

### D. Promoting Foreign Trade, Contributing to Further Implementation of the Policy of Opening to the Outside World

By reimbursement of taxes on exports and reimposition of taxes on imports, the value-added tax system will help "encourage exports and restrict imports," contribute to the continued implementation of the policy of opening to the outside world, make China's economy turn further toward the international market and participate more in international division of labor and international competition, and increase the ability of China's economy to compete with other countries of the world. China's present plan to

reimburse or exempt the repeatedly collected indirect taxes through all the production and circulation links is correct theoretically. In practice, however, it will be very difficult to base tax refunds on the actual conditions and accurate records of each enterprise. We can only determine by calculation the coefficients for tax reimbursement on thousands of products, which will be appropriate as a transitional reform measure.

The collection of value-added tax is highly "contagious." As soon as one or more countries take the lead in introducing the value-added tax system, their trading partners, especially neighboring countries, will rush to follow suit. After France introduced the value-added tax, all the countries around it clearly felt the pressure. This is because compared with countries which have already adopted the value-added tax, countries which have not yet adopted the tax are obviously at a disadvantage in the competitiveness of their export goods and of their domestic products against imports. Now, not only the developed West European countries and many developing Asian, African, and Latin American countries have implemented the value-added tax, but many countries including the United States and Japan are actively studying whether to reform their tax systems in this direction. Under the circumstances, whether we can implement a thoroughgoing value-added tax system will have a decisive bearing on the further implementation of the policy of opening to the outside world and the development of the national economy. It is obvious that the value-added tax will play an important role in enhancing China's economic competitiveness.

### E. Expanding Collection, Increasing Revenues

The collection of product tax requires checking and verifying the lines of production of enterprises. As far as the small and medium-sized enterprises are concerned, because they often change their lines of production and because of their numbers, collection is rather complicated and limited in scope. After the introduction of the value-added tax, which will be collected wherever there is added value, the scope of collection will be fully guaranteed. Therefore, in the beginning, the collection of value-added tax may result in increased revenues. Later on, revenues can be stabilized and guaranteed. When South Korea prepared to introduce the value-added tax and laid out plans on total collection and rates, it considered adopting a neutral policy, that is, to maintain the original level of circulation tax collection and make sure that there would be no drop in revenues. However, because the value-added tax enlarged the scope of collection and greatly reduced tax evasion, and because of the fairly good publicity and education campaigns before the introduction of the new tax system, the circulation tax revenues increased by 25 percent in the first year of collection. China's circulation tax revenues total more than 100 billion yuan a year, and a 25 percent increase will mean 25 billion yuan in added revenues. This kind of revenue increase is reasonable and does not add to the

total tax burdens of the normal tax-paying enterprises. It is achieved by closing loopholes and expanding the scope of collection, putting an end to the unreasonable tax breaks of the past, and thereby expanding the revenue sources. On the other hand, it will be easier for the treasury to increase revenues by value-added tax than by personal income tax. With a large population and a large number of people who have income but no strong sense of law, it is rather difficult to make sure that people report their incomes and pay taxes, and it is easy to evade paying taxes. In contrast, the number of enterprises is in any case much smaller than the number of people with income; the collection of value-added tax through sales is relatively simple and easy; and the personnel and other costs of collection are relatively low, which will help guarantee increased revenues. Moreover, the way in which value-added tax is collected is also pretty fair. As a certain percentage of tax is added to the price of all commodities, whenever a consumer buys something, expensive or cheap, he pays a tax indirectly. In other words, the value-added tax is ultimately paid by those who spend their personal income on consumer goods, but not by those who put their money in savings accounts which contribute to national construction.

### III. Necessary Conditions for Introduction of Value-added Tax

Normal operation of the market mechanism is prerequisite for the introduction of value-added tax, which in turn marks the development of the market mechanism. The following conditions are essential for the implementation of the value-added tax system.

#### A. A Rational Price Mechanism

Implementation of the value-added tax system must be based on a competitive market mechanism. Without a rational price structure, the collection of value-added taxes at relatively uniform rates could result in abnormal profits for some enterprises and abnormal losses for others. Conversely, unless the traditional circulation tax system with its numerous rates and uneven imposition is reformed, it is difficult to rationalize the price structure. Therefore, implementation of value-added tax and price reform must be carried out simultaneously, as they are mutually complementary and neither can be dispensed with. The prices of primary products should at least be made roughly reasonable and not differ too much from international market prices. As to finished products, generally they should be placed in the market, and let the market, that is, competition and the relation between supply and demand, determine their prices. It is obvious that a uniform value-added tax system is incompatible with the double-track pricing system like fire and water.

To achieve the goal, first of all, the prices of primary products must be rationalized. The problem which must be solved is that the official prices of primary products are set too low. Solving the problem concerns not only the optimum distribution of resources but a guarantee

for the state's tax revenues. Conceivably, if the prices of primary products (such as rolled steel, petroleum, cement, timber, etc.) are kept low, then not only will these raw and semifinished materials industries remain unable to have the development they need because of the abnormally low prices, but, as the entire processing industry including manufacturers of final products is built on these low prices, there will be confusion in business profits, tax revenues, and income distribution. If value-added tax is implemented under these circumstances, two situations will result: 1. If the processing industry has a reasonable profit rate, the prices of finished products will generally come down, and so will the entire country's circulation tax revenues. Conversely, if the processing industry has a high profit rate, it will inevitably lead to an abnormal production structure. 2. To avoid the above-mentioned situation, there is no choice but to settle with a less-than-thorough value-added tax. This is because the value-added tax rates are lower than the actual rates of the former product tax. Under the product tax system, primary products are not taxed; roughly processed products are taxed at a very low rate; and the circulation tax revenues come mainly from heavy taxes imposed on intensively processed products (such as color TVs, wristwatches, refrigerators, and other consumer goods and heavy industrial products like machine tools, power-generating equipment, etc.). After the implementation of value-added tax, the tax burden will become very even as a whole (the reason for this will be further discussed later), the much-too-low prices of primary products and the resulting much-too-low prices of processed products (added value) will cause a drop in the total amount of circulation tax revenues, not enough to meet the country's financial needs. In order to prevent the state's revenues from falling down, there is no other choice but to sacrifice the good points of value-added tax and implement an incomplete value-added tax system, that is, to continue to set a very high tax rate on processed goods. Obviously neither of these situations is good for the national economy.

At the same time, finished products in general must be introduced into competition. In the past, prices of finished products were set by the government and were very unreasonable. While implementing the value-added tax system, the prices of finished products must also be rationalized. However, there are tens of thousands of finished products, differing in varieties and specifications, and serious errors are inevitable in so many government-fixed prices. Therefore, corrections must be made through competition so that a new price structure can be developed. Otherwise, new problems will crop up. For example, while the prices of some products were set very high in the past, so were the product taxes levied on them, and if the same government-fixed prices are maintained after the implementation of the value-added tax, the enterprises producing these products will make a much higher profit and keep making it, resulting in over-development in these areas. Government-fixed prices and value-added tax, if used simultaneously, are bound to cause strong industrial deviations, which will

have extremely adverse effects on allocation of resources and distribution of income. Because product tax is collected according to a principle of differential rates, it is possible for the government to fix prices while keeping the earnings of enterprises at about the same level. With the implementation of value-added tax, only by decontrol and competition will it be possible to rationalize the price structure and bring enterprise earnings to a more reasonable level, which is also the process of rationalizing the production structure.

### **B. Unified Tax System and Markets**

To make sure that the value-added tax will play its proper role, it is imperative to have a unified national value-added tax system and a unified national market system. First of all, to implement the value-added tax in a big country, it is necessary to follow the principle of the division of tax revenues and clearly designate the value-added tax as a central tax. By central tax we mean that the tax rates must be the same throughout the country and must not differ from one place to another, and that the power to reduce or exempt taxation must be held by central tax departments and cannot be shared by local authorities. The purpose in making value-added tax a central tax is to insure that the tax collection system makes no trouble and that the unified neutral production policy is not distorted. Conversely, if local authorities have the power to reduce or exempt tax payments, it is tantamount to having different regional tax rates and unequal competition. Moreover, the degree with which invoices are valued differs between enterprises enjoying tax reductions or exemptions and those without such reductions or exemptions. Enterprises enjoying reductions or exemptions will not regard invoices as valuable or indispensable and may even sell them illegally, thereby disrupting the records on which value-added tax collection is based.

By calling value-added tax a central tax, we do not mean that all the value-added tax revenues should be put at the disposal of the central government. Instead, based on the expenditures of the central and local governments, the tax receipts can be distributed according to specific proportions, which is also called sharing.

At the same time, the implementation of value-added tax requires a unified market. Without such a market, the hoped for benefits from the implementation of the value-added tax, such as fair competition, rational distribution of resources, and rational distribution of income, will all come to nothing.

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### **C. A Strict Invoice System as Basis for Value-Added Tax**

Value-added tax cannot be implemented on an experimental basis, but must be put into effect throughout the country at the same time according to a well-prepared

plan. As mentioned previously, value-added tax is computed by deducting previous tax payments. To guarantee the reliability of tax computation, all invoices must have the same importance to all productive enterprises in determining their tax payments, and the loss of an invoice will mean more tax payment. At the same time, the invoices will also serve as the basis and proof for cost accounting and tax audit. This explains why value-added tax cannot be experimented with in some places or trades. If some enterprises are taxed, and others are not, or if some products are taxed, and others are not, the value and importance of invoices will not be the same. The purchase invoices will be very valuable to enterprises and products required to pay value-added taxes, but useless to those not required to pay value-added taxes. It is then possible that invoices will be transferred illegally from the latter to the former. With these kind of loopholes, an experimental plan will create opportunities for tax evasion, and it will be difficult to control. The only alternative then will be to go back to the past practice of setting material consumption standards, which is both subjective and hinders efforts to upgrade products.

### **D. Unified Deductions**

To implement the value-added tax based on a strict invoice system, the same kind of deductions must apply in all cases. The experience of various countries shows that basing deductions on invoices is a fairly reliable practice. To be deducted, all previously paid taxes must be listed specifically on the purchase invoices, and the deduction value of these invoices will not change, even though the products they are used on may be taxed at different rates. Unless the same kind of tax deductions is made universally applicable, the financial value of invoices will vary at the time of tax computation, thus creating loopholes on deductions and leading to tax evasions.

### **E. A Basically Unified Value-Added Tax Rate**

In most countries, there is basically one unified value-added tax rate. Only a few countries, which do not have a deep understanding of the characteristics and advantages of the value-added tax system, have adopted multiple tax rates. For example, Brazil has collected value-added taxes with 24 different rates, and this kind of multiple-bracket tax system has been publicly recognized as a failure. A basically unified tax rate means that most manufactured goods are taxed at the same rate, and that only a few final products may be given special treatment. Otherwise, there will continue to be such old problems as unequal deductions, lack of public supervision, hindrance to cooperation, and lopsided industrial growth.

### **F. Enterprises Assuming Responsibility for Profits and Losses**

To implement the value-added tax system, it is also necessary for the industrial and domestic and foreign trade enterprises to assume full responsibility for their

own profits and losses and to have business management. And responsibility for profits and losses must be based on rational prices and exchange rates. Without rationalized prices and exchange rates, some enterprises will be in no condition to assume responsibility for their own profits and losses, and the state will have to subsidize certain trades or enterprises for policy reasons. Being able to eat from the same big pot, these trades and enterprises will not treasure their purchase invoices, and these invoices will be transferred to others for tax evasion. Similar problems can also happen with sales or commercial invoices.

In short, the implementation of the value-added tax system will mean a whole series of reforms for the development of the market mechanism. Only when the tax system is implemented with a series of supporting reforms, will its great superiority be brought into play as expected.

#### **IV. Other Matters Concerning Implementation of the Value-Added Tax System**

In addition to the previously mentioned conditions indispensable to the implementation of the value-added tax system, attention should also be paid to the following matters.

##### **A. Adequate Preparatory Work**

Since the value-added tax system was first adopted in France in 1954, more than 40 countries have followed suit. The experience of these countries has shown that before introducing this new tax system, adequate preparatory work must be done, because this is a very significant reform to the old tax system, involving major readjustments to the interests of many enterprises. The preparatory work will include widespread propaganda and education, estimates on the interests of enterprises to be readjusted, and formulation of necessary transitional measures.

The major subjects of propaganda and education will be about how accounts on value-added tax should be kept, the great importance of every invoice, and so forth. How well the propaganda and education is conducted will be of crucial importance to the successful implementation of the value-added tax system. Before implementing the value-added tax system in 1977, South Korea had distributed large quantities of propaganda materials to give publicity to the way the tax system would be implemented and its advantages. The number of copies printed and distributed exceeded the total number of citizens. Radio, television, and other mass media were also employed at the same time. This kind of preparatory work can greatly reduce the shock and confusion in replacing the old tax system with a new one and insure, and even increase, financial revenues in the first year of the reform.

##### **B. A System Combining Tax Returns and Spot Checks**

The enterprises should file tax returns on their taxable transactions, and the tax departments should make spot checks on the contents of the tax returns to insure their accuracy and fairness. Falsification of tax returns should be punished with heavy fines or double taxation. Spot checks are simple and practical. First, all data used in spot checks are based on invoices; second, owing to the mutually checking relationship between the buying and selling sides formed by tax deductions, it is easy for the tax departments to make cross audits and minimize the chances of tax frauds and evasions; and third, if relevant instructions on the use of invoices are given by the industrial and commercial administrative departments, it will be easy to separate business expenses from non-business expenses. However, in the beginning, some enterprises are bound to take a chance and try to falsify the invoices. Therefore, more enterprises should be spot checked during this early period. But it is still spot checks, and not a general survey of all enterprises, which would be too much work to do. South Korea at first planned to check all enterprises, audit all data, and put the information in computers for verification. It made the value-added tax system too complicated and greatly increased the volume and difficulty of the work. Many people raised objections, complaining that the practice cost more than it gained.

##### **C. Dividing Line With Business Tax**

Some countries have set a starting line for the collection of value-added tax, and enterprises with yearly income below the starting line (family operated business, for example) are permitted to pay business tax, instead of value-added tax. Small enterprises are permitted to pay business tax for two reasons. First, their business volume is quite small, and the collection of specifically agreed upon business tax from them will reduce the tax collectors' work load and collection costs. Second, paying business tax is simpler than paying value-added tax for small enterprises, who often have no qualified financial and accounting staff. The question is where to draw the line. The starting line for the collection of value-added tax can be determined with reference to experiences of foreign countries and in light of the actual conditions of Chinese enterprises. In principle, it should be implemented to the greatest possible extent, that is, whenever feasible, value-added tax, and not business tax, should apply. Conversely, the application of business tax should be strictly controlled, really limited to small enterprises.

##### **D. Commercial Invoices**

Consumer goods retail invoices are often ignored. It is because most consumers do not have the right to the refund, exemption, or deduction of value-added taxes. When consumers buy things, they either do not demand sales invoices or take the invoices and throw them away. Thus, it is possible for some commercial enterprises to conceal their real sales volume and pay less value-added

taxes to the state. To solve this problem, some countries have adopted the following measures. One is the use of government-certified cash registers. The other is to operate a lottery using sales invoices as tickets. Specifically the measure is to prescribe the use of uniform and numbered sales invoices throughout the country, and to award cash prizes, with money provided by the state, to numbers drawn at a specific date each year. The winning numbers will be published in newspapers. With the adoption of this measure, the consumers will be willing to demand invoices when buying things, and will begin to save sales invoices. Although the invoices will cause some trouble to both buyers and sellers, they do give consumers a chance to win. Whoever holds an invoice with a winning number will receive a fairly large sum of prize money.

#### **E. Resistance to Value-Added Tax**

It is necessary to be prepared to deal with the readjustment of interests caused by the value-added tax and the resulting resistance to the new tax. On the one hand, the enterprises should be allowed to report how the new tax is affecting their interests, and interim remedial measures should be adopted to give aid to those suffering losses. On the other hand, it is necessary to be mentally prepared to face the reactions of the losers and stand up to the political pressures arising therefrom. South Korea faced great difficulties 3 or 4 years after implementing the value-added tax. Those opposed to the tax were vociferous. They rallied some political forces, particularly forces representing the interests of small businessmen, peddlers, and small enterprises, to voice their objections. It was only after the International Monetary Fund dispatched a rescue team to give counsel that South Korea was enabled to tide over the crisis and maintain the value-added tax system. To the enterprises, the value-added tax means a readjustment of interests. To make this reform safer without causing too much of a shock to the enterprises, it is necessary to adopt some buffer measures. For example, when France implemented the value-added tax system in 1954, it called on the enterprises to report whether the tax caused gain or loss to their interests. For those who suffered rather serious losses, the government would conduct an inspection, and, after proving that the losses were indeed serious, the enterprises were given a periodically decreasing subsidy for 1 to 2 years, which may be called a soft landing. There are also enterprises which have taken advantage of tax loopholes and avoided paying taxes in the past. These enterprises will also complain vehemently against a strict value-added tax system. No attention should be paid to such objections, because they are a normal phenomenon when tax collection is expanded and equalized.

#### **V. China's Present "Value-Added Tax" Not Thoroughgoing**

China has begun collection of value-added tax on a trial basis, but the current value-added tax system is faced with a series of problems. It is not a thoroughgoing value-added tax and needs to be reformed thoroughly.

#### **A. No Complementing Price Reform**

As mentioned previously, value-added tax must be implemented in coordination with price reform. Otherwise, not only will it be impossible to give play to the advantages of the value-added tax, but new problems will arise. Yet the present value-added tax reform is struggling in isolation. Because the price structure of primary products and manufactured goods has not been fundamentally changed, the isolated reform of the circulation tax system, which calls for a reduced number of value-added tax brackets, is faced with the difficult choice between reduced revenues or maintaining the multiple rates of the old product tax. At the same time, because the irrational price structure has not been reformed, some enterprises are making abnormal profits or suffering abnormal losses. The production policy embodied in the old product tax, which is designed to correct price distortions with different tax rates, has "moved to the second line," but the neutral production policy in the new tax is unable to take over and play its role. The result is a weakened production policy.

#### **B. Failure To Implement Separate Tax Systems and Break Market Monopolization**

When the product tax was originally introduced, some products (such as color television sets, wristwatches, etc.) were rather excessively priced and brought huge profits, but they were also taxed at very high rates. The high taxes took away the greater part of the profits from the enterprises, making them feel that selling these products was not especially profitable. But, because there was no distinction between central taxes and local taxes, and because of the financial system under which revenues were divided proportionally between the central government and local governments, known as "serving meals to different diners from different pots," the local financial authorities found these lines of production very profitable. The taxes were originally intended to check the lopsided development of production and excessive investment by the enterprises. Instead, they led to lopsided development of production and excessive investment by local governments, because the increased tax revenues flowed into the local coffers according to the proportions of the "different pots." The apparent conclusion: The only way to check the lopsided production development by the local governments is to implement separate tax systems and clearly designate all circulation taxes as central taxes. This is the only way to implement a unified national production policy. When we gradually introduced the value-added tax, we did not make it a central tax, but continued to let it be collected by the local financial authorities. As a result, all the lopsided production development under the old product tax system was kept alive. Owing to the number of tax rates and local differences, the present value-added tax has not only failed to perform the function of correcting the market signals, but failed to carry out the "neutral" production policy. It has also failed to solve the problem

of market monopolization by the introduction of competition. The problem of market monopolization can be solved through coordinated price, tax, financial, and foreign trade reforms, but not by the introduction of value-added tax alone.

#### **C. Failure To Implement Value-Added Tax Throughout the Country at Once**

As mentioned previously, because in computing value-added taxes, deductions are made based on invoices, it is imperative to have a strict invoice system. Therefore, the value-added tax cannot be introduced on an experimental basis, but must be implemented throughout the country all at once. However, the present value-added tax has not been implemented all at once. Instead, it has been experimented on a few kinds of products first and extended to other products gradually. Thus, a situation has resulted, in which value-added tax, product tax, and business tax are collected at the same time. We must understand that the present phenomenon of the old and new tax systems existing at the same time is bound to cause the new system's deterioration and lack of thoroughness, thus robbing the new system of its advantages and causing troubles to its future extension. With two or three tax systems operating at the same time, it is impossible to enforce the deduction and invoice requirements essential for the success of the value-added tax. The new tax system's many advantages—for example, the strict and reliable way of tax computation, the readily perceptible and easily applicable deductions, etc.—are lost. And, the old tax system's loopholes are also found in the new system. For example, because of our failure to enforce a strict invoice system, the enterprises are not under pressure to exercise financial restraint and pay attention to cost accounting, and it is still possible for them to keep two sets of books and cheat the state out of tax revenues. This series of problems have greatly reduced the effectiveness of the new tax system. It is about time that we considered introducing other necessary reforms in a coordinated way, instead of "experimenting" on the value-added tax piecemeal. If we do not, it is not only impossible to fully realize the benefits of the value-added tax, but new problems are bound to crop up.

#### **D. Failure To Adopt Uniform "Deductions" and Separate Tax From Price**

As mentioned previously, the computation of value-added tax is characterized by uniform "deductions" and separation of tax from price. It is simple, open, reliable, and strict; greatly reduces tax loopholes; and guarantees the uniform deduction value of invoices. However, the present value-added tax can deduct either previously paid taxes or a specific amount, and deduction procedures are not strictly followed. Also, the tax is included in the price. Thus, the above-mentioned advantages cannot be realized. And, because different taxes are in effect at the same time, the collection of circulation taxes is made all the more chaotic. It is said that the current

collection practice is to a very large extent based on component income, that is, to use the sum total of the earnings from various components as the added value to be taxed in each circulation link. However, we do not have a component market yet in China, and the fairness and reliability of the data used in the computation based on component costs is highly questionable. Moreover, because deductions by specific amounts, instead of previously paid taxes, will result in products being taxed at varying rates, the value of purchase invoices in tax computation will also change, and it will be impossible to guarantee the uniform deduction value of the invoices.

#### **E. Too Many Tax Rates**

There are still too many brackets in the present value-added tax system, a clear vestige of the product tax and internal business tax. For example, cotton textiles, polyester fabrics, and wool fabrics are taxed at different rates. The new tax has inherited the irrational factor in the old product tax of maintaining government-fixed prices with many tax rates and factors of the strongly partial production policy and consumption policy. Therefore, it is unable to play its role as a "neutral" tax with regard to production. Strictly speaking, it is not a value-added tax, but a slightly improved product tax. It strongly interferes with product prices, hinders the introduction of the market mechanism, and adversely affects the process of allowing the enterprises to make independent decisions on prices, setting the stage for all-round reasonable competition, and developing a commodity economy.

#### **F. Merging Tax Brackets at the Expense of the National Treasury**

In the past year or two, actions have been taken to simplify or merge the value-added tax rate brackets. It seems to be the reasonable thing to do as far as the requirement of the value-added tax system itself is concerned. The problem is that the merging has not been implemented in coordination with price reform. It is not designed to bring down the higher prices by abandoning government-fixed prices and encouraging competition and, at the same time, to lower the tax rates. Instead, it has simply lowered the tax rates while keeping the irrational price structure intact. As a result, some enterprises are making extra profits, and the state is losing tax revenues. This is, in effect, more profit for the enterprises at the expense of the state. On the other hand, products on the lower side of prices were taxed at lower rates in the past, whether it was product tax or value-added tax. Now, with the change to more uniform value-added tax rates, these lower-priced products are being taxed at higher rates. These products had a rather small profit margin even in the past. Now their tax rates have increased, but their prices are not allowed to change. Thus the enterprises dealing in these products are suffering serious losses, to the extent that their survival is threatened. Because these difficulties are caused by policy, the enterprises are certainly not to be



blamed. So the government is giving them various kinds of subsidies. For example, through preferential treatment in tax computation, they are given all kinds of deductions and exemptions in disguised forms, which in fact is allowing them not to pay taxes according to the regular rates. Therefore, the merging of tax rate brackets without the support of price reform inevitably leads to revenue losses. The financial difficulties in the past 2 years cannot be totally unrelated to these revenue losses. The value-added tax combined with the market mechanism can bring increased and more stable revenues by expanding the tax base, but implementation of the tax alone with the government-fixed prices remaining in effect will result in reduced tax revenues.

### G. Failure To Improve the Structure of Imports and Exports

Price distortions have a strong influence on the structure of imports and exports. The serious problems in the present structure of imports and exports cannot be solved by readjusting the exchange rates, if the price distortions are not corrected. The present price structure is very unreasonable. The prices of primary products are too low, and the prices of manufactured goods too high. Besides the unrealistic government-set prices, the unreasonable circulation taxes are also a major cause for the irrational price structure. With the way product tax is collected, the more intensively processed goods, which go through more production and circulation links, are more heavily taxed, and the tax on primary products is much too low. The result is a slanted price structure with abnormally low prices of primary products and roughly processed goods at one end and abnormally high prices of intensively processed goods at the other end. With such a price structure, it is impossible to have an exchange rate that is applicable to most import and export goods. However, if the indirect taxes paid through all the links can be completely reimbursed at the time of export, then the price structure of our export goods can be brought considerably closer to the price structure of the international market; the gap between prices in the domestic market and the international market can be narrowed somewhat; and a greater role can be played by reasonable exchange rates.

Under government-fixed prices, what could be accomplished by reimbursing all the product tax paid cannot be done with the present value-added tax, especially after the merging of its rate brackets. This is because the value-added tax rates on intensively processed goods are actually lower than the past product tax rates, so, even after reimbursement of the value-added tax, the prices of these products will be still too high to compete in foreign markets. At the same time, the tax rates on primary products are too high, and reimbursements can be too much. If the exchange rates are set at a level to help the higher-priced intensively processed export goods, then the primary products will make excessive profits owing

to the large tax rebates, which will encourage an irrational export mix, hinder the development of a suitable export pattern, and make planning and application of an export economic lever extremely difficult.

Similar problems also exist in imports. The levying of product tax on imported goods at nominal rates does not reflect the principle of giving imported goods the same tax treatment as domestic products, but gives too much preferential treatment to imported goods. This unreasonable condition should have been changed first before the introduction of the value-added tax, so that imported goods would be required to pay the same accumulated product tax as domestic products. It would enable domestic products to compete with imported goods on equal terms and, at the same time, give expression to our import production policy, that is, to give appropriate protection to national industries. Thus, appropriate reductions can also be made to customs duties. We have failed to pursue such a policy in the past, and should do it now. However, because we have introduced the value-added tax in some areas and have kept merging the rate brackets, we have lost the grounds to take the above-mentioned actions, which can give direction to our import pattern and will be easier to explain to other countries. We can only rely more on tariffs, import regulatory tax, and government review and approval to regulate the import pattern, and we are faced with unavoidable international censures.

In short, price distortions and the system of government price fixing require a policy tool to mitigate the distortions, and that is the product tax. The present value-added tax has unavoidably become a variation of the past product tax. Because of the lack of supporting price reform, the incomplete value-added tax has also lost the production policy embodied in the product tax, which was indispensable to the old price structure.

### VI. A Thoroughgoing Value-Added Tax Can Help Reform the Economic System

The value-added tax is a kind of tax which reflects the objective requirements of a commodity economy. It has already demonstrated its ability to promote large-scale socialized production, coordination among specialized departments, circulation, and foreign trade. China is at present engaged in restructuring its economy and continuing to pursue the policy of opening to the outside world. Under the circumstances, the implementation of the value-added tax is of great practical significance. A wealth of experience has been accumulated in the world in implementing the value-added tax, which can be used for our reference. If we spend some time preparing ourselves and draw up plans on supporting reforms, we will be able to make important progress.

#### A. International Experience

The length of preparation time for implementing the value-added tax varied from country to country. But the ways the value-added tax is implemented in various

countries have provided us with a wealth of experience, both positive and negative. In our second step in substituting taxation for profit delivery to the state, we have gained some understanding of the value-added tax. Particularly in the last year, during the preparation of the 1987 reform plans, the implementation of value-added tax was made a very important reform policy. Detailed preparations were made in the office of the State Council's leading group for structural reform planning, and the experiences of various countries in implementing the value-added tax were compared. With the experience of those before us to learn from and in view of the actual conditions in China, we think it is possible to implement the value-added tax in the whole country following about 2 years of careful preparations. We say that 2 years of preparations are sufficient because we already have some basic understanding of the value-added tax.

#### **B. Necessary Coordination With Price, Tax, Financial, and Foreign Trade Reforms**

First of all, the implementation of value-added tax must be coordinated with price reform. The prices of primary products should be rationalized or decontrolled on the whole. The prices of processed products should be decontrolled, and competition should be introduced so that new prices will be determined by supply and demand through fair market competition. At the same time, it is necessary to establish separate central and local tax systems, break the monopolization of markets based on administrative divisions, encourage competition, and put an end to the series of abnormal production growths brought by the decentralization of administrative powers. Moreover, industrial production and foreign trade must be turned into business operations, and enterprises in these two fields should begin to assume responsibility for their own profits and losses.

The major goal many countries, especially countries which depend heavily on foreign trade, hope to achieve through this tax reform is to actively participate in international division of labor and international competition, that is, to dovetail their domestic taxes on imports and exports with those in countries with the value-added tax system (EC countries, for example). To really benefit in reforming the foreign trade system, it is necessary to combine this tax reform with reforms of the exchange rate policy and domestic prices and the institution of business management in foreign trade. This kind of synchronized and coordinated reforms and the implementation of value-added tax, which will be reimbursed on exports and reimposed on imports, will prove to be extremely beneficial to the development of foreign trade and the national economy.

#### **C. Stepping Up Preparation of a Comprehensive and Coordinated Reform Plan**

This reform is of extremely great significance. The implementation of value-added tax must not be regarded simply as a tax reform, but should be considered,

planned, and introduced in combination with the structural reform of the economy as a whole. Only in this way can it produce the expected results. Proceeding from this understanding, we should seriously sum up the experiences of other countries in implementing the value-added tax. In this regard, the International Monetary Fund and other international organizations have done a lot of work and accumulated a great deal of information. We can ask them to provide us with more information, which will help us study and design our own plans in the light of China's actual conditions. We should step up our preparatory work so that a reform plan for the implementation of the value-added tax throughout the country can be introduced soon.

#### **Liu Guoguang Discusses Reform of Commercial System**

40060179 Beijing *CAIMAO JINGJI [FINANCE AND TRADE ECONOMICS]* in Chinese  
No 10, 11 Oct 88 pp 3-6

[Article by Liu Guoguang 0491 0948 0342: "Some Problems With Reform of the Commercial System"]

[Text] This article discusses some of the views on the issues of the objectives and models for reform of China's commercial system and the reforms that have taken place over the last two or three years.

#### **I. Reforms of the Commercial System Require an Overall Objective and Model**

Over the course of the last decade, reforms of China's commercial system have managed to shake up and break through the administrative management system of the past that was characterized by "monopolization" (state monopoly on purchases and contracting for marketing, state monopoly on purchases, marketing, and fixed supply). Reforms in such areas as internal enterprise management, commercial administrative management, the structure of the commercial ownership system and the forms of purchase and sales have all seen great successes. This has brought a thriving vitality to the domain of commodity circulation and made an important contribution to development of the socialist commodity economy and satisfying the diverse and growing demand of the people.

However, it is clear that currently the various abuses of the old commercial system still exist in great numbers and there are many problems in reform that urgently await resolution. We still have not altered the fact that large and medium-size state-owned commercial enterprises still act as dependencies of commercial administrative organs, their management powers of independent action and self-initiative remain minimal, and they lack the vitality for self development and the ability to compete in the market. The phenomena of limited circulation within sealed off areas and the creation of barriers remain fairly serious, the development of consumer product markets remains in its infancy, and it is

difficult for market mechanisms to correctly guide the management processes of the enterprises. The system of indirect macro-regulation has still not created an effective regulative force in fact, and this has led to many "vacuums" and loopholes. All sorts of illegal management activities have continued to emerge, and the rights and interests due the consumer have not been ensured. In particular, during recent years as commodity supply has fallen out of balance and commodity prices have risen, we have not persisted in resolving our contradictions through use of the market and the law of value but rather we have often reflexively taken the easy way out through use of the old system whereby we deal with a problem through administrative means, we revert to control, we base supply on pre-written orders, we restrict prices, and we restrict circulation. This has caused reforms to be "defective." The result of this kind of administrative intervention and control has not only shocked the entire nation but has increased the difficulties for the next round of reforms.

It should be said that reforms of the commercial system got an early start. However, reforms have not advanced to the results that were anticipated. In fact, they have even been set back to a certain degree. There are many reasons for this. For example, in the macroeconomic area, this has a very great relationship with the fact that there remain factors of instability in the economy as a whole. And as for commercial reform itself, one important reason could be that in the last ten years of reforms we have lacked clear objectives and models for dividing up our stages of implementation.

The practice of commercial reform proves that if there is no fairly clear concept of the overall objective of the reform or the overall objective of the reform is vague (for example: using the "three mores and the one less" as the objective and model for reform) we will end up with fuzzy thinking about the reform and the reform will lack continuity and systematization. Each item of the reform will produce hesitation and even cause us to fall back to where we were or else we will lose the opportunity to create a total response. With an overall objective for reform, we can decide on and carry out the steps to reform based on our overall objective and thus we assume overall responsibility and guidance for the reform in all its facets, we strengthen the steps of reform, we eliminate the various interferences and obstructions, and we gradually intensify the reform and press it on closer to its anticipated objective.

Commercial reform is the same as reform of the entire economic system in that both require a process of exploration and testing. Occasionally unavoidable problems will pop up in reform and it is unrealistic to require a fairly clear understanding of the overall objectives and models for reform in its initial stage. I raise the issues above in order that we may sum up our experiences and come to attach importance to study of the overall objectives and models for reform through facing up to the issues. Currently, commercial system reform and reform

of the entire economy are in the same place. Both have passed through the initial stage and are entering the crucial period where essential changes between the old system and the new must be made. Under these circumstances, the timely study, formulation, and selection of an overall objective and model for implementation of reform in stages assumes greater urgency and is indeed possible.

## II. The Selection of an Overall Objective and Model for Reform of the Commercial System

The overall objective and model for reform of the commercial system should coincide with the objective and model used for reform of the whole economy. What the objective and model of reform of the Chinese economic system, to put it simply, is to create a new planned commodity economy system. This is composed primarily of the objectives of the ownership system and movement mechanisms. The objective of the ownership system is to establish a mixed ownership system with public ownership as the main body, reconstruct the micro-foundations, and make the enterprise an independent main body of the market. The objective of economic movement mechanisms is to bring about "the state regulates the market and the market guides enterprise," a three-in-one formula whereby the three important links of enterprise, market, and state are organically joined around the hub of the market, and market mechanisms function to allocate primary resources. The objective and model for commercial system reform should embody the above-mentioned overall objective and model of economic reform in its domain of commodity circulation. Based on this principle and requirement, the special features that unite China's commerce and the objective and model for reform of the commercial system, we can neither revert to the administrative management system characterized by "monopoly" nor can we choose a laissez-faire system with total freedom of circulation. We should choose and build a new system where management is subject to market forces and the state exerts indirect macro-economic control. This objective and model contains the following key features:

A. Build a mixed ownership system of commerce with public ownership of commerce as the main body to vitalize commodity management and circulation.

B. Renew composition of the micro-foundations of commerce and make state-owned businesses independent commodity managers that truly possess management self-initiative and that are responsible for their own profits and losses. Make them main forces for the organization of commodity management and circulation.

C. Adhere to the inherent law of the commodity economy, and carry out free circulation of commodities, break through the regional walls and creation of barriers, and advance the creation of a unified domestic market all under the guidance of market mechanisms.

D. Carry out indirect macro-economic control over commodity management and circulation so as to ensure their healthy planned development.

The simple portrayal of the objectives and models for reform of the commercial system made above is certainly correct and I hope it gives rise to discussion and can be perfected through study. Here I would like to take up discussion of point B above regarding the commodity managers' independent position in state-owned commercial enterprises (in particular, large and medium-size commercial enterprises).

Prior to the reforms, state-run commercial enterprises relied on their administrative forces to monopolize the entire consumer products market. After reforms, numerous commercial components and forms emerged and this wiped out the administrative monopolies. The new development in commodity circulation demanded that state-owned commercial enterprises use their own economic power to give full play to their role as guide and reestablish their main position in commodity management and circulation through market competition. However, practice has shown that state-owned enterprises have not fared well in competition in recent years. The basic reason for this is that state-owned commercial enterprises have taken on dual roles, namely, on the one hand they have autonomy based on market conditions and the principle of profit maximization, and on the other hand they have been tasked by the government with setting the market straight and the government holds them responsible for this. With one eye on the market and the other eye on the government, these enterprises are caught in a "Catch-22" situation. We can see that if we are to turn these state-owned commercial enterprises into independent commodity managers, we must alter this abnormal situation of the commercial enterprise carrying out government functions and the government carrying out the functions of the enterprise. Granted, under conditions of strict differentiation between enterprise and government functions, state-owned commercial enterprises, particularly large and medium-size enterprises, should still be able to act as dependable forces for government regulation of the market. However, the government should set up a market regulation fund, and when there is violent fluctuation in the supply of certain commodities vital to the national economy and the people's livelihood, and, in addition, the normal management activities of state-owned commercial enterprises would not lead to the maintenance of basic market stability, the government could dip into this fund to subsidize those influential state-owned commercial enterprises and enlist them to take in or send out large quantities of commodities, calm down commodity prices, and stabilize the market so as to protect the just interests of producers and consumers.

### III. Thoughts on Commercial System Reform Over the Last Two or Three Years

The above-mentioned overall objectives for commercial system reform will require a fairly long period before they can be achieved. We can say that they are two long range

goals. Thus, after clarifying the overall goal or long range goal of commercial system reform, we still need to consider steps and measures for the near and medium term and link them up with the overall objectives or long range objectives. The course of moving from the near term through the medium term to the long term should gradually show alignment and the first reforms cannot set up obstacles for later reforms. Rather, the first reforms should set up a foundation for later reforms, create the proper conditions and gradually move toward the objectives and models. I would like to talk briefly on a few ideas for the near term in commercial system reforms.

A. We should promote the shareholding system at the same time that we perfect the contract system for state-owned commercial enterprises. We should push the enterprises toward becoming truly independent commodity managers.

Making state-owned enterprises into independent commodity managers and normalizing their relationship with the government is a basic feature of commercial system reform and is also one of the difficulties facing the reform. In recent years large and medium-size state-owned commercial enterprises have made an attempt at carrying out the contract system. Currently, some comrades in theoretical circles and practice departments are worried that the launching of the enterprise contract system in recent years has given rise to some problems and these problems could increase our future difficulties in making reforms. Indeed, there are two main defects that have come out of the contract system in recent years. One is that it could strengthen administrative mechanisms but not market mechanisms. So-called "command contracting," "fixed contracting," and "relationship contracting" belong to areas of non-market operations. Second, it makes it difficult to arrive at the goal of promoting management autonomy, and taking responsibility for profits and losses, and self-development and the common "haggling" between enterprises and government officials inevitably leads to the discussion of short term behavior on both sides. Yet it must also be recognized that a comparison of the contracting system with the original enterprise system shows that to a certain degree the contracting system has increased the independence and vitality of enterprises. Moreover, it has made the commercial system a reality throughout the country. We should skillfully guide our actions based on the situation and continually make an active search for ways to perfect the contract system. In the near term, the contract system for commercial enterprises should get coordinated price reforms and heightened consumption endurance from the advancement of such focal points as competitive contracting, improved management, and higher profits. At the same time, we must consider gradual advancement of the shareholding system and link and unite the two systems. Compared with industrial enterprises, commercial enterprises generally have fewer fixed assets, more circulating funds, and state-owned property is more easily dealt with and appraised. Because commercial enterprises are in the domain of circulation, the markets

change rapidly and the opportunities for risk are numerous. In carrying out the shareholding system it is easy to create profits and risk restriction mechanisms and thus efficient enterprises and entrepreneurs are brought up. Advancement of the shareholding system also creates beneficial conditions for state-owned commercial enterprises, especially large and medium-size wholesale enterprises, to develop enterprise blocs. Thus, I feel that in the next 2 or 3 years state-owned commercial enterprises could consider trying out the shareholding system, and through the clear division of property rights, the enterprises could truly become independent commodity managers with autonomy and responsibility for their own profits and losses. Also, this could accumulate experience that the whole nation could draw on in carrying out the shareholding system and the state could draw on in controlling these kinds of enterprises.

In reform of the commercial system, reform of state-owned wholesale enterprises could play a decisive role. Recent year transfers of central, provincial, or regional level wholesale enterprises down for merger with city wholesale enterprises in the same city or region and with similar commodity management has only succeeded in setting up a wholesale organization. In essence these kinds of reforms are only administrative divisions of power and are not structural divisions of power. These kinds of mergers contain the possibility of stronger consolidation of government and enterprise in a certain city or area and so bring on numerous new problems. In looking at it, the key points in reform of wholesale enterprises in the near term seem to be to make the enterprises independent commodity managers responsible for their own profits and losses and able to determine their own development and make an issue out of perfecting the management mechanism.

**B. Open up the market and strengthen market organization and management. Promote development and perfection of the consumer goods market.**

Follow the line of thinking proposed by the party Central Committee to basically complete price reform within 5 years, persist in the use of the market and the law of value to resolve supply and demand contradictions, and follow the current development trend in production and in particular agricultural by-product production to completely release all agricultural by-products and industrial consumer goods with the possible exception of such important products as grain, cotton, and oils within 2 or 3 years (or 3 or 5 years) and subject their management to market forces and controlled market price fixing channels. Promote the development of consumer good markets in order to provide a market environment where commercial enterprises can become independent commodity managers. Practice has proven that if we truly conduct business according to the law of value and give full play to the role of market mechanisms and price mechanisms in regulating supply and demand relationships, some of the commodities that we are now short of (mainly agricultural by-products) could quickly become

abundant. Of course, under the present conditions of aggravated commodity price rises, if we can't succeed at this undertaking, that is to say, if we can't control inflation, then it will be difficult for release of agricultural by-product and industrial consumer good prices to be effective. This problem is already outside the scope of commerce and I won't say anything more about it here.

In the area of strengthening market organization and management, we must put in order and gradually stabilize the purchase and sales relationships for important products, put in order and mediate in circulation channels, and reduce the links in circulation. We must improve the market infrastructure, we must set up the necessary infrastructure and technological outfittings that are suitable to the flow of commerce, the flow of goods, and the flow of credit in the large and medium-size cities, in the communications and transportation hubs, and in the collection and distribution centers and we must strengthen market circulation. Currently, we also especially need to formulate and promulgate "commerce laws" and "market management laws" that are suitable to the current stage of commodity economy development so as to strengthen management of the market, tighten up market sequences, establish rules for market exchange and fair competition, regularize market management activities, standardize and normalize the behavior of the main bodies (the enterprises) in market management activity, and promote healthy market development in good market sequences.

**C. The functions of commercial administrative departments need to be changed.**

Over the last decade of reforms, commerce has seen the emergence of "everyman a trader" and the commercial activities throughout society have been separately administered to by numerous administrative departments. At the same time, aside from the administrative departments, we have also had numerous organs with administrative functions carrying out different kinds of specialized administration over commercial activities and a tendency toward division of administrative powers has emerged. Practice has proven that there are enormous disadvantages to having this kind of scattered administration over society's commercial activities and having the government crawling out of the woodwork. Commerce is an important industry in the national economy, and it needs to be administered by one specialized, united organ. If we are now still unable to create a new authoritative organ to unite the administration of society's commercial activity, then it is extremely necessary that we task special bodies with the function of united administration over national and local commerce.

However, this kind of administration by commercial administrative departments is by no means a form of direct intervention in enterprise behavior. What this requires is that the departments follow the principle of the separation of government from enterprise and change their functions, moving from the direct management and

administration of enterprises as in the past to indirect administrative service, return commercial management rights to the enterprise, and change the enterprise from being a dependency of the administrative department to an independent commodity manager. After government and enterprise responsibilities are separated, the primary functions of the commercial administrative departments of various levels will be to formulate specific policies and regulations for commodity circulation for the whole society, study and formulate strategic objectives of commercial development and medium and long term development programs, make timely studies and forecasts and disseminate market information. Also, they will guide the direction of enterprise management primarily through economic means and provide consultation, talent, and technology services to the enterprise. We must complete the change in the functions of the commercial administrative departments through separation of commercial administrative powers and property ownership rights and separation of property ownership rights and enterprise management rights. We must promote rational and effective working of commodity circulation in its entirety through the legalization, systematization, and higher efficiency of the functions of the commercial administrative departments.

Completion of the reform mission of the commercial system depends primarily on the commercial departments and the broad masses of commercial workers. However, it also requires a certain macroeconomic environment and macromarket environment. It also requires the co-ordination and support of production, financial, tax, transportation, and shipping departments. We should note that good reform of the commercial system could vitalize production departments, give production an enormous boost, cause an abundance and variety of goods and products, and spur on the uplifting of the entire national economy. This could both guarantee a prosperous and stable market, perpetually improve the people's lives and satisfy the masses and also promote and advance the intensification and successful development of the reform of the whole economic system and the gradual establishment of a new order in the socialist commodity economy. Thus, we must continually overcome that line of thinking that stresses production and slight circulation. Everywhere we must attach importance to and support reform of the commercial system. Theoreticians must also do more study and discussion on reform of the commercial system.

**Dual Release, Joint Reform of Prices, Wages**  
40060182 Beijing CAIMAO JINGJI [FINANCE AND TRADE ECONOMICS] in Chinese  
No 10, 11 Oct 88 pp 24-28

[Article by Liu Rongcang 0491 3310 3318 and Song Ze 1345 0463 of the Finance and Trade Materials Economics Research Institute of the Chinese Academy of Social Sciences: "Linking Prices With Wages and the Interrelated Transformation of the Economic Movement Mechanism"]

[Text] Note: Discussion of wage reforms, wage release, and the subjection of wages to market forces in this article refers only to enterprise wages. No reference is made to the

*reform of administrative or institutional wages that are closely tied in with the budget and conditions of state finances.*

This article deals with price and wage reforms, two inseparable key links in the process of mechanism transformation and reform intensification. Our stance is that we should move from the urgent countermeasures of adjusting prices and wages or releasing prices and adjusting wages that have been undertaken in recent years toward releasing both prices and wages (that is, matching up the "dual release") as the heart of our decisive countermeasures. Along these lines, the most valuable issue to discuss is whether we should promote the transformation of the wage mechanism so that it becomes subject to market forces at the same time that we carry out the mechanism transformations on dual track prices and single track prices that are subject to market forces.

#### **I. The Predicament of the Drag From Prices and Wages and Economic Reform**

The intensified contradiction between prices and wages signifies the appearance of deep contradictions and the concentration of system contradictions that have come about since China has engaged in economic reforms. Because they have been subjected to the sluggish drag of the price and wage mechanism transformation and because the initial results of the reforms are slowing down, the various contradictions have greatly increased and bound each other up in a "fast knot." Such contradictions as those between the cities and the villages, industry and agriculture, speed and results, savings and consumption, supply and demand, and micro-behavior and macro-adjustment and control have all tended to become exacerbated under the drag of the price and wage "fast knot" and have all unravelled up the chain of "fast knots."

Price drag. Price reforms are both a key and a difficulty. Before, price reforms were carried out along the lines of observing a plan of "looking after both stability and vitality at the same time and combining adjustment and release" whereby we stuck to seeking stability and opened up toward a seeking of vitality. This put most products, particularly agricultural products and industrial raw materials, on the dual track price system one after another. Because of the extensive guidance effect that prices have on production, distribution, exchange and consumption, the dual track price system aggravated the dual track system of economic movement and we saw the emergence of two sets of resource deployment, product exchange, and income distribution systems that were separated from each other and defined by two kinds of price discrepancies. This in turn caused a rapid increase in the complexity of economic life, a huge drop in transparency, and the continual increase of incompatible, unstable factors. Observed from the viewpoint of integration of economic movement and whole market

functioning, it is indeed unavoidable that in the period of brief transition we must partially transform the price mechanism or partially subject prices to the market forces. But, if this kind of transition becomes drawn out to the long term, the dual track system itself could very well go from being transitory to solidifying into a lop-sided system created out of the unity of two maladies. Thus, the only correct answer to follow up reforms is to put an end to price drags and rapidly carry out a total track transformation of the price mechanism led by the release of prices. However, the primary obstacle to transformation of the price mechanism is the issue of wages.

**Wage drag.** To a considerable extent, the price drag we have encountered in our intensification of reforms originates from wage drag. Proper ordering of wage relationships has all along been a main item in reforms and has also been a difficulty we have faced up to now with a greater background in comparative price reforms. If we say that in our earlier reforms adherence to a partial release of prices led to partial subjection to market forces, then wages are basically still a passive follow up under administrative co-ordination. Precisely because of the contradiction between a passive follow up and a partial subjection to market forces and the contradiction between administrative co-ordination and partial market co-ordination, expansion of the consumer fund has directly resulted.

Wage costs are a key element that go to make up the prices of consumer goods and basic products. The latter follow a feedback loop in deciding wage costs. As long as prices and wages form a united mechanism, the two basically can be co-ordinated. Since we have engaged in reforms, wage expenditures restricted by means other than the market, in passive follow up placement relations and in satisfaction of the various compensatory demands, have become a primary reason for the rapidly rising impetus of partial subjection of prices to market forces. But consistently high price levels have struck back with a ceaseless call for wages to follow, resulting in never ending expansion in the scope and ground covered by enterprise and financial compensation. This is what makes up the revolving "price" and "wage" cycle of death. The price-wage contradiction has become more acute under conditions whereby the mechanism has been partially or not at all transformed. At the same time, the two have also been mutual obstacles to mechanism transformation. The primary crux of transforming operating mechanisms in the economy lies in the "fast knot" of prices-wages. Additionally, this has manifested the enormous ability of defiance in the old system and demonstrated that the earlier hidden results of reforms through pure release of power and allowances are now basically discharged and finished and that reform route that takes the easy way out is no longer applicable. The numerous contradictions that have bound prices and wages up in a "fast knot" and lended themselves to continued dual track movement have brought about serious consequences in numerous directions. Namely,

mechanism transformation has bogged down, resource deployment has been wrong, distribution relations have been chaotic, profits have been washed away in a big way, currency speculation has been the rage, and increase in social wealth has been only nominal. Economic behavior has been made short-term and economic life has decayed from consumption. At the same time, the stagnation in mechanism transformation has provided excellent opportunities for a new kind of bi-directional permeation. On the one hand, all sorts of extra-economic privileges have invaded the market and caused disintegration in the deep layer composition of the market. On the other hand, market exchange principles have intruded into non-market territory and won over certain enterprise personnel and a portion of the public party and government employees through "direct linkage" where they are working out "mutual benefit" networks. Abuse of authority is on the rise as is other forms of corruption such as evasion of duties and the giving and taking of bribes.

In our earlier reforms, we adjusted the surpluses in interest relationships through prices and wages but the mechanism transformation was insufficient. Prices and wages are merely an arm of administrative power allocation. Sensitive issues, in particular income distribution, were handled through the use of non-market methods. Although we made several attempts at micro-economic reforms, the price-wage mechanism remains in a state of contradiction and is still far from being in a market track. This has much to do with discrepancies in our research on theoretical and strategic countermeasures. While discussing the issue of "on what do the reforms hinge," we mainly limited ourselves to the ownership system and prices. We failed to give enough importance to the system of labor wages. Actually, wage reform, in a microeconomic sense, ties in with transformation of the enterprise management mechanism. In a macroeconomic sense it ties in with the savings and consumption ratio. In resource deployment it promotes flow and options in the labor force. In a market system, wages are not only a sensitive market parameter like prices and interest rates, but also are a bottom line of defense in bolstering not only price reforms but reforms of the economy as a whole. Thus, if we overlook wages in our discussions of reforms, there is no way for us to think about or be successful with matching things up or transforming mechanisms.

## **II. Joint Reform of Prices and Wages; Adjust Both, Adjust and Release, or Release Both?**

Price and wage drag is comprehensive and if we are to undo the "fast knot" we must employ comprehensive counter reforms. What kind of comprehensive reforms should we adopt? Currently theoreticians and decision-making organs are favoring the use of price release and wage adjustment. We feel that a large area, multi-series product price release, a basic wrap up of the twin track system and promotion of price subjection to market forces is a bold conception. If we achieve this goal, it will

have a far-reaching effect on economic reform, mechanism transformation and development of production enthusiasm in the market system. However, if we only focus on price reform compensation, don't simultaneously carry out wage mechanism transformation and continue adjusting wages to support price release it seems that it will be difficult for price reforms to meet with the anticipated results.

As mentioned earlier, there is an indissoluble bond between prices and wages, and price drag is wage drag to a great extent. Thus, employment of wage adjustment subsidies to put off reform of the wage mechanism would be tantamount to preventing price reform.

A. Price release and wage adjustment will lead to an intensified conflict between prices and wages. Price release means that prices are put out to be subject to the market forces and prices are determined by market supply and demand relationships. And, while wage levels and the wage system continues under administrative coordination, we will not be able to build a market feedback loop wherein prices and wages mutually check each other. Thus, we will encounter acute comparative amounts in the two movement mechanisms and demand created by wages will still be divorced from market forces and will not be subject to market restricted demand.

B. Price release and wage adjustment will exacerbate rising consumption and inflation. In the comparative amounts of the two mechanisms, any enterprise, individual, social stratum, or group has reason to demand income subsidies from the government. No matter what choice the government makes, the result will be the same. Namely, the coverage and scope of wage adjustment subsidies will continually expand in non-standard discussions outside the market and state financial income will fall as expenditures increase. Every increase in wage expenditures will add demand weight to the market scales and administratively induced demand will pull market prices up. In the end, any wage expenditure will openly or covertly find its way into product costs. This is equivalent to administratively induced wage costs pushing market prices up. Rising prices can become an inducement for another round of wage adjustment subsidies. In this sort of death cycle, there is no way for the government to guarantee that it won't overprint currency. This will exacerbate inflation and currency devaluation. While finances and wages are powerless to follow up, the only choice for the government will be to impose a large scale commodity price freeze to compensate consumers, stabilize enterprise operations and management and ease the peoples unrest. It can be seen that using a wage system under administrative coordination to support the subjection of prices to the market forces is a self-contradiction. This kind of a wage system will withstand the release of prices through such channels as currency printing, pulls on demand and cost advancement and will become bound up with prices in a fast knot at a higher level. Thus, price

release and wage adjustment reforms are "inseparable demons." In addition to subjecting ourselves to a point-less risk on one front, it is quite possible that we will get nothing out of the whole affair.

We feel that a matched up dual release, namely release of prices and release of wages, would cause both prices and wages to advance side by side in their subjection to market forces. Price reforms would spur on wage reforms and wage reforms would support price reforms. Let us build price creation and income distribution on the foundation of market movement. Theoretically, subjection of wages to market forces refers to labor wages being founded on regulation through market supply and demand relations during the course of their self-determined flow and bi-directional options. The goal of reform whereby wages are subjected to market forces is to maintain the market unanimity of the wage and price creation mechanisms and their regulative effect, build a competitive wage system and labor system consistent with the competitive price system, and take the ultimate authority for determining wages away from the government and the inner levels of the enterprises and give it to the market process.

It is worth pointing out that products in China are "united" for the reason that there are supply shortages. The labor force is just the opposite. It is "united" for the reason that it has grown incredibly fast and is now at an absolutely excessive overload. The control over the two different types and the goals of developing the commodity economy, raising the rate of efficiency for resource deployment, and increasing product supply run counter to each other and inevitably both are strengthened. In this sense, reforms can only go from dual control to dual release. There is no possibility of "combining control and release." General theoretical knowledge tells us that precisely because China has a glut of manpower resources and the hidden or open unemployment in the cities and villages is widespread (including the working unemployed) the conditions are right and we should cast off the yoke of the controlled economy and use the market mechanism of lowered prices due to supply exceeding demand to hold back gratuitous wage increases and creeping costs reflected in prices. Viewed from our ordinary awareness, our cultural traditions and their ability to run in a counter direction, our nation appears to be most lacking in the conditions for subjecting wages to the market forces. Up until now, from the enterprise, the individual, social strata, and groups of government organs, upper level construction and ideological territory there hasn't been enough psychological preparation to be willing to abandon the ordinary, thoroughly reform the wage system, and establish an awareness of competition and risk. This "ideological deficiency" in putting things out for the market to decide is extremely ill-suited to achieving the proposed price reform goals. We feel that in essence whether there are conditions after all and whether we want to support the subjection of prices to market forces by subjecting wages to the market forces is not a theoretical issue but rather



is an issue of choices for implementation in reforms or improvements. In the modern world, and the reform practices of socialist nations evidence this most clearly, if price reforms are carried out without the simultaneous transformation of the wage mechanism, the prospects of success are not good at all.

### III. Thoughts on Adopting the Countermeasures of Dual Release and Joint Reform of Prices and Wages and the Interrelated Transformation of Economic Movement Mechanisms

Comprehensive matched up reforms having as their main focus of attack the undoing of the price-wage "fast knot" in essence is an unavoidable idea for a strategic battle that has been under consideration for quite some time. Thus, we need to establish a line of thinking for the strategically matched up reforms that is led by dual release of prices and wages. The overall goal of the battle is to build up the main part of a new economic mechanism within about 5 years whereby the state regulates the market and the market guides enterprise. The battle hinges on using the "dual release" method to overcome the difficulties in joint reform of prices and wages, resolving the problems we had in earlier reforms of relatively sluggish mechanism transformation, fostering and building a market system, perfecting market organizations, and causing the reforms to enjoy great progress in a comprehensive and substantive way. To date there has been a great deal of talk in the battle for reform about enterprises, prices, the tax system, the financial department, finances, investment system reform and other matched up moves of unity. Now we need more talk about how to bring wage reform into joint alignment with other movement, and how to solve some of the main problems that inevitably will be met with in dual release of prices and wages.

#### A. Basic conditions for dual release of prices and wages and problems in grasping the opportunity.

The process of subjecting prices and wages to market forces must be suited to the new order of the socialist commodity economy, to the gradual build up of the market system, to market organizations, to the day by day perfection of market standards, to the formative condition of a "framework" for the socialist market economy, to macro-control capacities centered around the market, and to an effective degree of adjustment and control. Only in this way can we free price and wage reform from administrative coordination and move toward subjecting it to market forces. And only in this way can price and wage mechanism transformation meet with success when the conditions are right and be continually strengthened. Precisely because of this, based on China's actual situation and in particular the degree of market development, the preparation that has been made for a "release," and the ability of a "release" to endure, the only appropriate measure to adopt is a gradually advancing, variegated reform with divided phases and levels. But, the basic direction of the reform

is a route of advancement using release of commodity prices and release of wages. For example, the different demands that agricultural products and industrial production materials put on the endurance of state finances and the different scopes that the reforms will extend to allows us to first release the prices of agricultural products, first release the prices of production materials, or wait for our chance to pull off a dual release of both. We have many options.

#### B. Keep the reform of subjecting wages to market forces in line with the subjection of prices to market forces.

As the reforms intensify, workers' individual income will come from many different sources but the primary form of income will still be wages. The overall line of thinking in the reform whereby wages are subjected to the market forces is that we will move from the present conditions whereby wages function basically to resolve problems of subsistence and the system of average wages for subsistence toward wage differentiation and remuneration for efficiency and the labor force will change from a united plan of distributions to allocations subject to market forces. At the same time that product prices are left up to the market, the wage levels for employees in different lines of business will be primarily determined by market wage rates and held together by the labor contract system. Specific key features are: (1) The specific form, structure, and differentiation of enterprise wages is unlimited, but wage expenditures including awards must be completely subject to competitive costs and wages should not be based on enterprise profit but should be linked up to the wage rate for market labor conditions. At the same time that enterprises and the state carry out differentiation of tax brackets, wage brackets and profit brackets, we should use market mechanisms to sever the relationship between wages and profits. Enterprise profits represent the need to establish a balancing of relationships between wages and workers founded on the going wage rates in the market. The individual income of entrepreneurs and high salaried scientists and technicians should be determined based on the going wage rates in the market and market norms. (2) Completely open up the labor market. Implement bi-directional options between enterprises and employees founded on free flow of labor. Let the unemployed compete in the open market, allow enterprises to release employees, update their employees and let workers freely choose their jobs, find new employment and open up second jobs. (3) Government at all levels will no longer directly meddle in the micro-business of wage income nor will it press the obligations stemming from "united contracts." The key points for macro-control include forecasting, guiding long-term trends in the price and wage markets, and using financial policies, currency policies, industrial policies, and income distribution policies to level out violent short-term fluctuations in the market wage rates. Provide guidelines for long-term trends in various wage rates for various occupations to both sides of the labor supply and demand market and stipulate minimum employment and minimum wages for certain periods.

Use labor productivity rates, commodity price indices, and conditions in the national economy as bases. Promulgate for reference the indices of wage rates and amounts for the various occupations and professions, promote the subjection of employment to market forces and the reasonable adjustment of wage structures, and keep the market wage rates rational among the different occupations. (4) Create conditions for the flow of the labor force. This includes widespread establishment of employment agencies and training institutes (run primarily by the people), the creation of individual employment files and reform of the household registry and housing systems. (5) Establish a basic living security system combining social security and self-security based on consideration of the maladies of our traditional system, the lessons of certain rich nations and the conditions of our current phase of poor ability for individuals to ensure their own self-security. Shift payments of state finances to those who are unable to work or who have lost their jobs and the dependents of these persons as well as persons in low income levels. At the same time, make strong efforts to establish individual insurance. On the issue of social living security, we must both prevent a lopsided tendency to rely on the state and a lopsided emphasis on individuals providing for their own security. (6) Establish the corresponding progressive tax on individuals and inheritance tax system and make suitable reductions in the tax levy point that matches up with the security system. After subjection of wages to market forces is effectuated, we should avoid huge disparities of income between workers by taxing those with high incomes so as to provide funds by which the state financial departments can divert payments to the needy. Items (5) and (6) should be restricted so that the allocation rates and movement standards in the labor market are not harmed. (7) After implementation of the reforms whereby the market forces govern, there will be coherence in the market feedback loop for wage and price movement, and enterprises will face roughly the same competitive market environment. Thus, we would ideally see a huge reduction in those so-called "policy burdened" enterprises, as well as the subsidies and tax breaks given them. Also, such things as employment subsidies seen overtly as subsidies for consumer goods and covertly as lowered housing costs and medical and health protection would ideally be cut way back until they are basically eliminated. The government can use some of the income it gets from the cut back in those huge subsidies to make the various social security payments. (8) At the same time that enterprise wages are subjected to market forces, the wage system in unprofitable organs should be gradually standardized. The wage system for government employees, teachers, and institutional officials should also be competitive. Also, we should permit officials to move around where appropriate and this includes enterprise switching.

In view of the fact that we have product shortages, price structures change on their own, interests have been traditionally rigid, and we need a suitable period for the release of prices and wages, we may encounter a period of dual

rises in prices and wage levels as we go about matching up the dual release. However, the subjection of prices to market forces will stimulate supply and inhibit demand and a price system that was originally unreasonable will be rectified by the market. Subjection of wages to market forces will create a competitive self-balancing between individual supply and individual income and raise the efficiency of labor resource deployment. Thus, through a short-term collision between price and wage levels we will gradually come to coordination and stability.

#### C. Partial matching measures centered around dual release.

Key issues now facing us include how to eliminate the various forms of interference, ensuring the successful switch to dual transformation at the cost of a rise in both prices and wages, and averting a new "fast knot" during the dual rise. It should be acknowledged that because we have already seen overblown economic growth, meteoric rises in investment, consumption (particularly group consumption) and inflation, a tendency away from savings and toward consumption and consumption structures, and the principle pluralization of "equitable distribution" created through the direct linking of an equal income ideology and group interest, there are no real major difficulties or risks in carrying out dual release. We feel that aside from the matching up itself of the price-wage dual release, we must work on primarily the four following matching measures at this point: (1) Strengthen the ability of state finances to endure a dual release of prices and wages. Prior to the basic completion of the price-wage mechanism transformation, it is extremely important that state financial power be used to support us in light of the social, economic, and psychological pressures that will result from a dual rise in prices and wages. Thus, we must carry out the necessary financial preparations. In addition to the original measures of reducing expenses and increasing income, we could see the fastest near-term results by auctioning off small state-owned enterprises. Also, at the same time that we make housing a commodity and carry out rent reform, we should organize the sale of state-owned housing (primarily houses) and transfer the rights to the term compensation from city land use rights as soon as possible. These three measures will divide state finances into stages (the first two) and allow for a fairly income (the third measure). This could not only gradually eliminate the state financial deficit, but could provide for a healthy financial income in the future. (2) Carry out a side by side transformation of subsidy mechanisms and price-wage systems. Core problems during the period of price-wage mechanism transformation will be that the subsidy system cannot be completely eliminated and yet we must find a way for subsidies to be more effective. This is the only way we can avoid the original maladies and fit into the direction that subjection of prices and wages to market forces is going. Currently, the various subsidies we pay out account for approximately one-third of the state's financial income. This has become a

difficult burden to bear. Price subsidies are the biggest chunk and most of them are for agricultural by-products. There are two options to consider for reform in this area. The first is to take the agricultural by-product subsidies which in the past were directed only to the consumer and make them go to both consumers and producers so as to stimulate an improvement in the overall supply and structure of agricultural by-products. A gradual reduction in consumer subsidies could also induce lower consumer demand for agricultural products and ease the contradiction between supply and demand of agricultural products. Second, change the agricultural product "general benefits system" of subsidies which extends to all consumers and persons of different income levels into a subsidy that extends only to those in the lower income levels. Change the unlimited subsidy into a limited subsidy, the indirect subsidy into a direct subsidy, and the covert subsidy into an overt subsidy. The cut-off point and standards to determine low income can be fixed based on such factors as historical conditions and commodity price levels. This will both ensure the appropriate rise in the basic living standards of low income persons, and effectuate a regulation of income levels and income structures and a reduction in financial expenditures. In addition, we should include rent subsidies in the subjection of wages to market forces so as to do away with the current abuse of most rent subsidies going toward houses which creates an artificial housing shortage. (3) Control the "three inflations" and keep the "three rates" in line. Extraordinary economic growth directly caused the three inflations of investment, consumption, and currency inflation. Extraordinary growth usually takes three forms. The first is a lopsided seeking of output value which creates high speeds of growth through integration (including incomparable, irrational vertical integration and horizontal integration between regions, departments and businesses). The second is high speed growth that is forced because of low results. The third is high speed growth that is maintained through indiscriminate printing of currency and financial "over-distribution." The common result of these high speed measures is the destruction of stable, coordinated economic development and interference in the achievement of the goals of reform. What is the appropriate economic growth rate? We feel that China must make use of the successes at home and abroad and basically keep the growth rates for the economy, currency supply, and investment in line with each other or move in this direction. This is the historical post-war trend certain economically developed nations have shown and is also the way developing nations and regions such as Singapore, South Korea, and Hong Kong have gone. Practice verifies the fact that this is of great benefit in maintaining the appropriate speed of economic growth, the continued stability of national economic growth, and relative balance between overall supply and demand. This in turn creates the necessary economic environment for the dual release of prices and wages. (4) Carry out the changes that will take us toward our goal. The key issue is to make a clear determination based on comparison of advantages and disadvantages and resolutely abandon

those goals, supreme though they may be, that must be abandoned. We must move toward making policy determinations based first and foremost on efficiency. Equity should also play a role in our long-term policy for national development and reform. Only in this way can we maintain and develop the productive forces and speed up the growth of overall social wealth. This is also the only way we can maintain an abundance of macro-control while some get rich before others. In carrying out dual release reform, we must allow ourselves plenty of room to maneuver.

## FOREIGN TRADE, INVESTMENT

### Resolving Foreign-Funded Enterprises' Foreign Exchange Balance Problem

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[Article by Yu Shiyuan 0060 0013 0337 of the Legal Office, General Administration of Exchange Control: "Discussion on Solving Foreign-Funded Enterprises Balance of Foreign Exchange Problems"]

[Text] The ultimate goal of foreign businessmen in China is to make profits. An enterprise's operation and management is reflected in whether there is sufficient foreign exchange to guarantee the remittance of foreign businessmen's lawful profits. This is precisely a question of the enterprise's foreign exchange balance.<sup>1</sup> The currently used methods and measures for ameliorating the foreign exchange balances of foreign-funded enterprises in China are incapable of fundamentally meeting the foreign exchange needs of foreign businessmen to remit abroad lawful renminbi profits. As a result, the foreign exchange balance issue has become a critical factor in foreigners' decisions to invest in China. This article will investigate the problem.

### I. A Simple Analysis of Present Methods for Resolving the Foreign Exchange Balance Problem

At present, there are five main ways of resolving foreign-funded enterprises' foreign exchange balance problems: (1) Allow foreigners to reinvest their portion of renminbi profits and enjoy preferential treatment. When considered from present circumstances, this option is of little practical significance in resolving foreign-funded enterprises' foreign exchange balance problems. This is because if a foreign businessman invests his renminbi profits in a new project, he will straightaway run into the same problem with the solution still an unknown. If he invests in the original enterprise and further expands production, this can only worsen the foreign exchange balance problem. (2) Provide full compensation. With the approval of foreign economic trade departments, a foreign-funded enterprise showing a foreign exchange balance deficit can use renminbi to purchase domestically produced goods to bring about full compensation

and attain operating funds or remit abroad lawful foreign exchange profits. However, compensation can resolve only a limited number of foreign exchange balance problems since there are restrictions on purchases of unified management products for export by foreign businessmen. Furthermore, few non-unified management goods can be provided to foreigners for export due to quality, quantity, price, market, and other factors. (3) Have foreign exchange secured renminbi loans. It is stipulated that foreign-funded enterprises may take foreign exchange that is temporarily idle and use it as collateral with banks and financial organizations approved to engage in such business in order to obtain renminbi loans. When necessary, renminbi equal to the original sum may be used to redeem the secured foreign exchange. There are no interest charges on secured foreign exchange and renminbi loans. This method has been welcomed by foreign investors. It allows foreign-funded enterprises to acquire needed renminbi funds without converting foreign exchange, thereby reducing the hidden perils of foreign exchange imbalance. The present foreign exchange secured renminbi loan operations can be further expanded in the future. For example, there could be additional investment in capital stock secured renminbi loans of more than 10 years. Starting from the sixth year, redemption of collateral foreign exchange would be permitted at a ratio of not less than 20 percent per year in order to guarantee recovery of the foreigner's invested capital stock. Or, we might grow into foreign exchange negotiable securities and fixed capital securities, foreign exchange loans, etc. (4) Substitute products for imports. If a temporary foreign exchange balance problem arises during the initial stage of operations of a joint venture or contractual joint venture truly offering advanced technology needed domestically which produces goods that have to be imported, while bringing about domestic production, it can apply to the appropriate agency to substitute products for imports. This method is favorable for the introduction of advanced technology and key equipment. It can partially replace imports of goods, and is advantageous to conserving the state's foreign exchange expenditures. The scope of substituting products for imports should be further expanded in line with the domestic situation. Any products with appropriate technology, those which have the potential to upgrade China's commodity exports, as well as those that can cut down on the state's foreign exchange expenditures should be allowed to apply for import substitution. (5) Regulate foreign exchange surpluses and deficiencies. At present, regulating is the main way to remedy foreign exchange deficiencies in foreign-funded enterprises. However, the amount of foreign exchange that can be regulated undergoes substantial fluctuations because there is little regulatable foreign exchange now. This directly affects the production and production costs of enterprises that use regulated foreign exchange to supplement operating capital. It also increases operating and management difficulties, and slows the growth of production. In order to perfect foreign exchange regulatory methods, the state could designate a particular organization that would allocate

special funds to regulate price restraints by adjusting the supply and demand market on foreign exchange, buying when there is a lot and selling when there is little.

At present, channeling surplus foreign exchange to areas where needed is one major way of resolving foreign-funded enterprises' foreign exchange balance problem. Considered from the long-range view, the issue can be basically resolved by opening a foreign exchange regulatory market in line with reforms in China's foreign trade system and increases in the collection of export proceeds. Nevertheless, the task of importing and exporting concurrently will be turned over to localities in the initial stage of reforming the foreign trade system because China's import rigidity and export flexibility are quite strong. There may be a substantial foreign exchange shortage period since localities nationwide will be reserving foreign exchange; for reserves to increase, there has to be a process of local level accumulation. Thus, at the beginning of the reform and development of foreign exchange regulatory markets, it may happen that foreign exchange demand will exceed supply. When the time comes, we ought to be prepared for foreign-funded enterprises' foreign exchange balance problem to become more pronounced.

In sum, it can be seen that to resolve this matter appropriately we must also adopt new measures and methods in addition to the further implementation and perfection of currently used ones.

## II. Suggested New Methods for Utilizing Foreign Exchange

A. We should adopt a policy of handling different cases of foreign investment in China differently. Namely, (1) we should adopt a policy of "differentiating projects of a productive nature and those of a non-productive nature." Foreign investors in projects of the former type should be given various types of favorable terms and encouragement. As the number of this type of project increases, there may arise auxiliary commercial service industries, such as tourist hotels, rental cars, food and beverages, and maintenance services. In view of the actual tight state of funds for domestic construction, future service-oriented projects of the aforementioned type may still be approved of for foreign investment, but without provision of any preferential treatment. Economic means should be used to adjust the proportion of production and non-production related projects. (2) We should adopt a policy of "treating the coastal and inland areas differently." We should invite foreign investment in coastal areas in export-oriented enterprises to augment China's foreign exchange earnings from exports. This will spur on the realization of "both ends abroad, high volume imports and exports" in coastal economies. At the same time, we should also encourage foreign investment inland along with the creation of import substitution enterprises. We can make inland and coastal economic development complement each other, moving

in synchronization, by fully utilizing the superiority of inland raw materials to develop commodity products, thereby reducing China's foreign exchange outlays needed for imports.

The policy of differential treatment can allow enterprises of a productive and non-productive nature develop hand-in-hand while the coastal and inland economies grow in concert, thus making for proportionate development of the entire national economy.

B. Regarding the foreign exchange incomes of joint ventures and contractual joint ventures, above all we should guarantee foreign investors' remittance of lawful profits, after deducting foreign exchange funds needed for production. When China absorbs foreign investment in future, we should encourage it for the transformation of existing enterprises. In principle, we should not build new factories, with the exclusion of those for new industries. To inspire foreign investment in transforming existing old, domestic enterprises that do not earn foreign exchange or very little of it, the most important thing besides granting various types of essential preferential treatment is to guarantee that there is enough foreign exchange for the remittance of lawful profits. Prior to transformation through foreign investment, the products made by these old enterprises cannot be exported to earn exchange or earn very little, even though the Chinese side has ample factories, equipment, land, etc., to offer as shares of a joint venture or contractual joint venture. Therefore, after deducting the foreign exchange funds needed for production when a joint or contractual joint venture earns foreign exchange income, we can ensure above all to guarantee the remittance of a foreign investor's profits. A lack of funds can be handled by regulatory means. Surplus funds can be dealt with by reapportionment to the Chinese partner in a joint venture (contractual joint venture) rather than the method in use at present of division between both parties in a Sino-foreign joint venture (contractual joint venture) according to the investment ratio. This foreign exchange earnings apportionment system can motivate foreign investors to export actively without any harmful influence on China's international balance of payments.

C. Under the premise that companies must achieve their own foreign exchange balance, we should allow foreigners to open conglomerate firms in China. The majority of big firms overseas now are organic conglomerate companies capable of integrated trade (domestic and foreign), production, scientific research, and investment. These firms want to promote their products in China because they also engage in import and export trade as well as production. They can also buy from us their needed products and raw materials. Permitting foreign investors to open conglomerate companies in China will help Chinese products enter the international market. We can use their capital and technology as well as sales channels, and expand our commodity production capacity.

Assumptions concerning conglomerates' capabilities, structures, and foreign exchange handling are listed below. (1) On the capabilities of conglomerate companies. These are wholly foreign-owned limited liability companies (or stock companies) opened by foreign investors in China. They can engage in approved import and export businesses or invest in production facilities they are interested in. They are allowed to conduct all business in China using renminbi for accounting and cashing. They are required to achieve a foreign exchange balance independently. (2) On the structure and operating mechanisms of conglomerate companies. Their structures are: The company establishes a certain number of wholly foreign-owned, joint venture, or contractual joint venture exchange earning or exchange using enterprises. Producing companies must export and sell their products in China. Their operating mechanisms are: To invest their technology, equipment, and capital in an existing Chinese company (of the exchange earning type) in order to upgrade the quality of their products and bring them in line with the company's export targets, considering the demands of the conglomerate company's overseas controlling (branch) company or the international market. After processing raw materials obtained on the domestic market, such companies have exclusive export marketing rights. Another mechanism is to invest their technology, equipment, and capital in an existing Chinese company (of the exchange using type), making technical renovations and replacements such that processing can be done on raw materials and semi-finished articles imported by the company for later sale on the domestic market, considering the domestic market and production demands. For those who want to make technical renovations and replacements on existing domestic enterprises, a joint venture or contractual joint venture can be made with the conglomerate company using joint shareholdings, contracts, leasing, or other methods. An enterprise's right of use may also be sold to a company for a set time period, in which case the company will independently operate it. (3) On handling the foreign exchange of conglomerate companies. Renminbi alone must be used for payments and settling accounts in all business transactions of conglomerate companies' operations in China (including business dealings with subsidiaries and subsidiaries' purchases and sales in China). In this way, the issue of foreign exchange balance will not lie in subsidiary enterprises, but will be held within the business operations of the conglomerate. We should adopt the method of "using exports to determine imports, and independently seek a balance" to guarantee foreign exchange balance. That is, there will be no restrictions on the varieties and amounts of imports and exports. A determination of a company's import sum will be made in accordance with the sum of Chinese-made commodities it exports. However, commodities exported by a company must be produced by its subsidiary. Likewise, a company's imports must be raw materials or semi-finished goods needed by its subsidiary. Conglomerate companies may neither directly procure nor market products on the domestic market nor can they use renminbi for purchases to regulate foreign exchange without special permission.

A method such as this really adheres to the tenet of "trade reciprocity." By giving foreign firms a portion of the domestic market and in exchange for expanding their operations, old domestic enterprises get needed technology, equipment, and capital for technical renovation and transformation. Although a part of the domestic market is given away, there can be no conflict with the domestic market or the production of the national bourgeois industrialists since the conglomerates' subsidiaries originally are old domestic enterprises.

**D. Listed stock corporations.** At present, the chief way of utilizing foreign investment for energy, transportation, public works and other large-scale key projects in China's economic construction as well as for rising risk industries is through direct foreign loan borrowing. These items naturally involve foreign exchange income. The state mainly is relied upon for returning the principal and paying interest on foreign borrowing, but there will be debt risks once the state's foreign exchange balance plan cannot be met on time. Foreigners are uninterested in direct investment on quite high risk, long investment term projects. We should set up listed stock corporations to issue stock and attract foreign investment as a means of foreign investment on these projects while also reducing risks. The specific measures are: Have the state specially designate projects to create stock companies. Sell the stock publically on the market. The shares can be divided into: (1) Renminbi general shares. These are general shares issued for free purchase by individuals, groups, and enterprises. Renminbi capital will be raised for the project and renminbi dividends will be given as the company's business situation allows. (2) Proprietary technology and equipment stocks. These are monetary share stocks on the proprietary technology or equipment of enterprises, groups, or individuals, issued to obtain said technology or equipment for a project. These stocks provide renminbi and foreign exchange dividends on domestic and foreign proprietary technology and equipment, respectively. These stocks can be neither transferred nor sold while the project is under construction. (3) Redeemable foreign exchange preferential stocks. These are a kind of share which foreign

investors are allowed to buy directly using foreign exchange. They may also be the assessed value of a project's needed import equipment. Preferential shares have a specified dividend rate. Holders have priority in getting dividends, although the shares do not denote voting power at shareholders meetings. A company and said shareholders can redeem shares at face value based on business conditions. Dividends on preferential shares are paid out entirely in foreign exchange. Moreover, taxes on exchange transactions can be avoided. The foreign exchange also can be freely remitted abroad. The foreign exchange source for dividends is state-allocated reserves, central units, or local governments (depending on the project). The three above mentioned kinds of shares may be transferred or sold by the holder. At certain times, holders also have the benefit of avoiding income taxes.

If implemented, listed stock corporations will turn independently-owned enterprises into jointly-owned ones. This may lower investment risks. That, plus the fact that foreign investors can enjoy preferential treatment such as guarantees on the remittance of foreign exchange earnings, avoiding taxes, and free transfer of shares, may be a strong magnetic force. Public issuance of listed stock can solve the matter of urgently needed capital, technology and equipment in China's economy. It can also turn the state's direct foreign debt into capital by reducing foreign debt redemption risks and the debtor danger of feast or famine. When necessary, it can provide the initiative for share redemption to ensure proprietary rights in construction projects and stock companies, thereby upgrading China's capacity to utilize foreign investment while expanding the scope of the state's usage of foreign exchange.

#### Footnote

1. There are three ways to express a foreign exchange balance problem, namely, in terms of foreign exchange balance, surplus, or deficit. The problems referred to in this article are limited to those due to deficits in foreign-funded enterprises' foreign exchange balance.

## EAST REGION

### Gu Xiulian Addresses Jiangsu Administrative Forum

OW1301020389 Nanjing XINHUA RIBAO in Chinese  
30 Dec 88 P 1

[By reporter Zhu Xinhua]

[Text] Speaking at a provincial meeting of directors of administrative bureaus for industry and commerce, Governor Gu Xiulian said: Administrative departments for industry and commerce must correctly handle four kinds of relationships in the new year.

—We must correctly handle the relationship between improving the economic environment and rectifying economic order on the one hand and deepening reform on the other. We are improving the economic environment and rectifying economic order, while adhering to the general orientation of reform and opening to the outside world. Improving the economic environment and rectifying economic order are necessary and will guarantee in-depth reform and economic stability. At the same time, many of the measures taken to improve the economic environment and rectify economic order are themselves important elements of reform.

—We must correctly handle the relationship between supervision and management on the one hand and supporting the policy of opening to the outside world and enlivening the domestic economy on the other. We must strengthen the supervision and management of enterprises, individual businesses, and trading centers and markets and, at the same time, support them in their efforts to develop production and increase effective supply to society through reform and opening to the outside world.

—We must correctly handle the relationship between rectifying the market order and cultivating and building the market. The main purpose of rectifying economic order is to eliminate the chaotic phenomena appearing during the transition from the old to the new system, to guarantee the orderly operation of the circulation channel, promote the development of market forces, and establish a new socialist commodity economic order. Closing the market and suffocating circulation are definitely not its intent.

—We must correctly handle the relationship between investigating and punishing illegal business operations and protecting legitimate businesses. We must support and protect efforts to further improve the contractual responsibility system for enterprise operation, to promote enterprise merger and integration, to establish enterprise conglomerates, to implement a shares system on a trial basis, to improve enterprise structures, and to carry out normal cooperation and exchange in goods and materials. On the other hand, we must sternly deal with, in accordance with the law, those who engage in

profiteering and speculation, drive up the price, seek huge middleman profits, and commit other acts in violation of the law and discipline. We must not shield them or be soft on them.

### Jiangsu Leaders Meet Theoretical Workers

OW1501132389 Nanjing Jiangsu Provincial Service  
in Mandarin 1015 GMT 12 Jan 89

[Text] This afternoon, Gu Xiulian, Sun Jiazheng, Hu Fumin, Fu Hao, Zhou Ze, and other leaders of the Jiangsu Provincial Party Committee, the provincial people's government, and the provincial advisory commission met and had discussion with representatives who attended the [national] theoretical forum that marked the 10th anniversary of the 3d plenary session of the 11th CPC Central Committee.

During the meeting, Hong Mingqing, Zhang Dongfeng, Chen Yi, Wang Anning, Wang Wenfu, and Yan Qiang—winners of an essay contest—as well as Hu Chengzu, deputy head of the Propaganda Department of the Jiangsu Provincial Party Committee; Hu Fumin, president of the Party School under the Jiangsu Provincial Party Committee; and Hu Xuxian, deputy secretary of the Nanjing Municipal Party Committee—representatives to the national theoretical forum—reported the study of the theory on the initial stage of socialism in Jiangsu and the national theoretical forum last year. They freely talked about their feelings and hopes, and put forward many useful proposals.

Governor Gu Xiulian fully endorsed the successes Jiangsu has achieved in the theoretical field. She pledged that the provincial government would use actual deeds to express its support for theoretical workers and their work. She also urged every one to contribute more to Jiangsu's economic development and the nation's theoretical studies.

### Xu Qin Addresses Jiangxi People's Congress Session

OW0501043789 Nanchang Jiangxi Provincial Service  
in Mandarin 1100 GMT 29 Dec 88

[From the "Provincial Hookup" program]

[Text] Before the end of the Sixth Session of the Standing Committee of the Seventh Jiangxi Provincial People's Congress this afternoon, Xu Qin, chairman of the Standing Committee, delivered a speech which focused primarily on the general inspection of law enforcement conducted in the province.

Xu Qin said: Last March, the First Session of the Standing Committee of the Seventh Provincial People's Congress adopted a resolution to conduct a general inspection of law enforcement in the province. In September the provincial people's government submitted a report to the Fourth Session of the Standing Committee on the general law enforcement inspection conducted in government departments throughout the province. The current session heard,

examined, and discussed the reports by the provincial Higher People's Court, the provincial People's Procuratorate, and the Political and Law Committee of the provincial People's Congress. As revealed in these reports, the work of law enforcement by public security and judicial organs in the province is generally successful. Considerable achievements have been noted in striking against serious criminal acts and economic crimes. This has had an important effect on ensuring the implementation of the reform, open policy, and economic construction. On the whole, the law enforcement contingent is good. The general inspection of law enforcement activities has received the attention of party committees at all levels in the province and has enjoyed support from all sectors of society. It has also been followed with interest and welcomed in earnest by the broad masses of people in the province. It has attained the goal stipulated in the original plan.

On the other hand, the law enforcement inspection has uncovered some problems. For example, the work done in various localities and departments has not been even. Some cases that people have frequently and strongly complained about have yet to be investigated. With regard to the implementation of the Criminal Law and the Law of Criminal Procedure, there exists the problem of ineffectiveness in striking against criminal acts. Some units have not dealt with criminal cases according to the law, while others have not done well in handling such cases, which has resulted in mistakes. It is imperative to sum up experience and to draw lessons from these problems. Mistakes should be corrected by seeking truth from facts. Meanwhile, a number of problems revealed by the inspection have been resolved, but some problems remain. With regard to the latter, continued efforts should be made to seek solutions.

Xu Qin added: Practice has proved that a general law enforcement inspection is a fairly good way to gear up supervision by law. The recent general inspection has made us aware of three things at least: 1) although legislation is important, from a certain view, it is more important to pay attention to law enforcement; 2) the key to successful law enforcement is to raise the quality level of law enforcement personnel; and 3) in gearing up law enforcement, it is impossible to do it once and for all, and persistent efforts are imperative.

Xu Qin said: As for how to conduct the inspection of law enforcement next year, I think that we can do the following four tasks: 1) to make arrangements to hear reports on law enforcement by the departments concerned; 2) to purposefully select one or two laws and check how well they are being enforced; 3) to investigate, in particular, some major cases violating the Constitution and laws and, after the relevant facts have been found, deal with the cases openly in order to let people know more clearly how we handle them; and 4) to begin to study and to formulate a set of regulations governing the inspection of law enforcement in order to institutionalize such an inspection and thus ensure the normal progress of this work.

### Zhejiang CPC Congress Approves Committee Work Reports

#### Discipline Inspection Commission

OW1301000789 Hangzhou ZHEJIANG RIBAO  
in Chinese 28 Dec 88 p 2

[Text] The 8th Zhejiang Provincial CPC Congress' Resolution on the Zhejiang Provincial Discipline Inspection Commission's Work Report

(Passed on 27 December 1988)

The 8th Zhejiang Provincial CPC Congress has approved the Zhejiang provincial discipline inspection commission's work report.

The provincial discipline inspection commission has enthusiastically helped the Zhejiang provincial CPC committee do a great deal of work to consolidate party style and tighten party discipline. It has played an important role in party building.

The congress urges the provincial discipline inspection commission and discipline inspection commissions at various levels to continue to implement the principle of running the party in a strict manner. They should concentrate on establishing good party discipline, help the Zhejiang provincial CPC committee establish sound party style, and make resolute and ceaseless efforts to completely implement the CPC central committee's lines, principles, and policies for the promotion of reform, opening to the outside world, and the modernization drive, and for the integrity and high efficiency of party and government organs. Party committees at various levels must intensify leadership over discipline inspection work, and continue to intensify education on party spirit, style, and discipline. All CPC members, especially leading cadres with party membership, must conscientiously accept the discipline inspection commission's supervision, stand the test of being in power, reform, and opening to the outside world, and genuinely bring the exemplary vanguard role into full play.

#### Provincial Advisory Committee

OW1301012389 Hangzhou ZHEJIANG RIBAO  
in Chinese 28 Dec 88 p 2

[Text] The 8th Zhejiang Provincial CPC Congress's Resolution on the Zhejiang Provincial Advisory Committee's Work Report

(Passed on 27 December 1988)

The 8th Zhejiang provincial CPC congress has approved the Zhejiang provincial advisory committee's work report.



Playing a positive role, the Zhejiang provincial advisory committee has assisted the Zhejiang provincial CPC committee in doing a great deal of important work since the 7th Zhejiang provincial CPC congress. This congress expresses its satisfaction over this, and respect for the old comrades' hard work.

The congress hopes that the advisory committee will continue to bring into full play its function as a political counselor and assistant to the Zhejiang provincial CPC committee in the coming 5 years, and that it will make new contributions to the complete implementation of the CPC Central Committee's lines, principles, and policies, to Zhejiang's reform, opening to the outside world, and modernization drive, and to the promotion of party unity and the intensification of party building.

#### **Officials Denied Concurrent Positions in Zhejiang Enterprises**

*OW1401063489 Hangzhou Zhejiang Provincial Service in Mandarin 1000 GMT 7 Jan 89*

[Text] The general offices of the Zhejiang provincial CPC committee and the Zhejiang provincial people's government recently issued a joint notification regarding incumbent party and government personnel conscientiously abiding by the provisions on not holding concurrent positions in enterprises.

The notification says: Recently, some personnel in provincial level party and government organs have abided by these provisions and resigned from their concurrent positions in enterprises. However, to this date, some units have yet to deal with the matter seriously. According to incomplete statistics, 85 cadres from 35 units holding the rank of deputy division chief and above still hold concurrent positions in enterprises. In this connection, the notification of the general offices of the provincial party committee and government laid down four provisions.

First, incumbent personnel of party and government organs at the provincial level who still hold concurrent positions in enterprises, except for those under consideration and permitted to do so for the time being, must resign from one of the positions. Within their jurisdiction for cadre management, the relevant departments responsible for their appointment and removal must supervise and execute these provisions, and accomplish them by the end of January.

Second, incumbent personnel of party and government organs who hold concurrent positions in provincial enterprises located outside Zhejiang, including enterprises located in Hong Kong and Macao; or who represent shareholders to attend board meetings in joint-stock enterprises located in Zhejiang, hold concurrent positions such as chairman, deputy chairman, or member of the board of directors, but are not directly involved in

their management, will continue to do so for the time being, pending consideration. However, they must not receive any salaries, allowances, or articles from these enterprises.

Third, incumbent personnel of provincial level federations of trade unions, women's federations, CYL, federations of literary and art circles, and societies and associations of various mass organizations, who hold concurrent positions in enterprises will be dealt with according to the aforementioned principle.

Fourth, retired cadres from party and government organs who hold positions in enterprises will be dealt with according to the relevant provisions of the central authority.

#### **CENTRAL-SOUTH REGION**

**Guangzhou Cracks Down on Criminal Activities**  
*HK3112053388 Beijing ZHONGGUO XINWEN SHE in Chinese 1600 GMT 26 Dec 88*

[Text] Guangzhou, 26 Dec (ZHONGGUO XINWEN SHE)—In the past week, the public security organs in Guangzhou City tracked down 175 prostitutes and brothel visitors. This is the first time the Public Security Department of this city has openly published a figure of this kind.

Afterwards, Wang Long, a responsible official of the Guangzhou City Public Security Bureau, briefed the mass media here on the results of the unified action against all kinds of criminal activities in the past week. He said that through this action more than 1,100 criminal offenders of all kinds were arrested, including more than 500 roving criminals and suspects for various criminal activities. In this action, more than 70 criminal gangs were smashed; and more than 700 criminal cases, including more than 300 major and serious cases, were cracked.

It is learned that the number of roving criminals in Guangzhou City has doubled in the past few years. Between January and November this year, the number of roving criminals arrested in Guangzhou was 15 times that of 1979. These roving criminals came from other provinces, and they committed such crimes as robbery, fraud, theft, and murder after coming to Guangzhou, seriously disrupting law and order in this city.

In the recent action, the public security organs in Guangzhou City concentrated strength on cracking a number of major and serious cases, which severely harmed society. Specially picked teams were organized to crack these cases, and various means of investigation were used. Many well-hidden criminals were caught, and criminal gangs were smashed. At the same time, actions were also taken to straighten out the social order in some districts and to wipe out some ugly and evil social phenomena. In this action, more than 170 prostitutes and brothel visitors, more than

30 criminals who trade pornographic articles, and more than 40 gambling organizers were arrested. More than 800 pornographic video cassettes and some pornographic books were confiscated.

Wang Long pointed out that this action had effectively dealt blows at criminal offenders and checked their arrogance. There are now still some unstable factors in society, and it is impossible to immediately check the upward tendency of the incidence of criminal cases.

He said: Public security organs at various levels have worked out their concrete action schemes, and will continue to deal heavy blows at roving criminals and other serious criminal activities. Small shops, rooms for rent, construction sites, small hotels, and other places where criminals can easily hide themselves will be thoroughly inspected. Gambling, prostitution, and the spread of pornographic books and video products will be thoroughly banned and suppressed.

#### **Hainan University Foundation Established To Procure Education Funds**

*HK3112060188 Haikou Hainan Provincial Service in Mandarin 2300 GMT 27 Dec 88*

[Text] The Hainan University Foundation was established in Hainan University on the afternoon of 27 December. The foundation named Xu Shijie as its first honorary chairman, Liang Xiang as chief supervisor, and Liu Zhuotai as its president.

The main purpose of the Hainan University Foundation is to give wide publicity to the significance of developing Hainan University, solicit support from people at home and abroad, enhance the teaching quality of this university, and cultivate more high-class professional talents for Hainan's modernization.

The foundation will set up branches in Hong Kong, Macao, and overseas areas. Through efforts made by executives in various branches, the foundation will arouse more people's enthusiasm for making contribution to the development of education in Hainan.

Provincial Governor Liang Xiang made a speech at the inauguration ceremony of the foundation. He valued the noble spirit of the people in all parts of the country and in overseas areas who have made contributions to the development of education on their home land, and issued appointment certificates to some permanent honorary chairmen and permanent honorary councillors. Leaders of the provincial party committee, the provincial government, the provincial people's congress, the CPPCC provincial committee, and the Haikou City Government attended the foundation's inauguration ceremony.

At the inauguration ceremony, some Chinese people who now live in the United States, Canada, and Hong Kong immediately contributed HK\$120,000 to the foundation.

## **NORTHEAST REGION**

### **Harbin Students Petition Authorities To 'Punish Hooligans'**

*HK2301064189 Hong Kong TA KUNG PAO in Chinese 23 Jan 89 p 2*

[Report: "Five Hundred Students in Harbin Take to the Streets Urging the Government To Punish Hooligans Who Wounded a Student With a Knife"]

[Text] More than 500 students of Harbin Engineering University went into the streets on the afternoon of 10 January and petitioned the provincial government to sternly punish the hooligans who wounded a student called Qiu Haidong and to strengthen security on the campus. The students were filled with indignation and the bystanders totaled 9,000, resulting in a traffic jam for more than an hour. Through dialogue conducted between various departments and the students, the demonstrators returned to the campus.

On the evening of 8 June [as published], three hooligans kidnapped a girl from the ballroom of Harbin's railway cultural palace. On the way, they seriously wounded a worker for no reason at all. When the girl escaped, the hooligans flew into a rage. It so happened that Qiu Haidong, a student of Harbin Engineering University, passed by. The hooligans cut his face with a knife for no reason. Qiu was sent to the hospital for emergency treatment. He is out of danger but there are 54 stitches on his face.

After the accident, the police immediately took action to crack the case and arrested two people. As the other one escaped, the police are now searching for him.

The accident did not affect the situation in the university. The examination proceeded smoothly, without a single student absent. A number of students spoke highly of the efforts made by the police. Now the condition of Qiu Haidong's wound has improved and he can move. His parents arrived at Harbin from Xian to see him.

### **Liaoning Outlines Party-Building Tasks**

*OW2701181789 Beijing DANG JIAN [Party Building] in Chinese No 11, 5 Nov 88 pp 9-10*

[Article by Sun Qi, deputy party secretary of the Liaoning Provincial CPC Committee: "Play the Advanced and Exemplary Role of a Communist, so as To Bring More Benefits to the People"]

[Text] Since the 3d plenary session of the 11th CPC Central Committee, particularly since the 13th National Party Congress, all levels of party organizations in

Liaoning have obtained much experience in exploring new ways and methods to bring the role of party organizations and party members into play while closely attending to the task of rural reform and economic construction. For example, the Striving for Common Prosperity Group jointly formed by the party committee and the masses in Changtu County of Tieling City and the contest among party members and cadres to launch undertakings in Jinzhou District of Dalian City are both the result and crystallization of party building efforts in the rural areas. Their experience reflects the guiding thought that party building should serve economic work and improve the party's style of leadership over rural work. The group has helped to find an effective way to raise the quality of party members and give play to the role of a party member in the new situation. In short, their experience provides significant and universal guidance to Liaoning Province in the building of the party in rural areas. Learning from and promoting their experience will play an important role in developing a commodity economy in the rural areas, in playing an advanced and exemplary role as a rural party member, and in further doing a good job in party building.

#### **I. The Work of Party Building Must Serve the Party's Basic Line**

The report delivered at the the 13th National Party Congress points out: All party work in the new period must ensure the implementation of the party's basic line. The nucleus of the party's basic line consists of one pivot and two basic points; the two basic points are unified around the pivot of economic construction. Therefore, the work of party building in the new period should stress this pivot and make the promotion of the development of social productivity a basic starting and resting point. We should establish the firm guiding thought of serving the party's basic line, of revitalizing China and Jilin, of developing an export-oriented economy, and of serving a commodity economy. In the rural areas, we should serve to carry out the second stage of reform and development of a commodity economy and should lead the masses to general prosperity. This guiding thought should be implemented in all areas and all aspects of party building. The party committee of Changtu County in Tieling City and the party committee of Jinzhou District in Dalian City have stressed this pivot point of economic construction in rural reform and actively explored and improved the work of party building. Proceeding from the reality of rural economic development, they have summed up and promoted in a timely way the experiences of the Striving for Common Prosperity Group and the contest among party members and cadres to launch undertakings. They have creatively implemented the guiding thought in party building. Their good experience comes from the creative implementation of the guiding thought.

#### **II. We Should Strengthen the Building and Reform of the Party in the Course of Reform and Opening to the Outside World**

Embarking on the reform of the economic and political structures objectively calls for a corresponding reform in party building. The major contents of the reform of party building are:

First, we should establish a new concept of the definition of capable people in the new period and do a good job in building leading bodies at the grass-roots level. Since the party rectification campaign, leading bodies at the grass-roots level in the rural areas of Liaoning have undergone readjustment, resulting in the raising of the quality of the leading bodies in grass-roots units. However, still fettered by the thinking of a self-reliant natural economy and small-scale farmer economy, leaders of some party organizations are still influenced by remnant "leftist" thinking when it comes to recruiting personnel. They dare not employ party members and cadres, who, despite some shortcomings, understand the commodity economy and know how to lead the masses to prosperity. Even when they make use of the services of those capable persons with shortcomings, they do not let them have a free hand. Readjustments have not been made among those cadres who, although good in quality and willing to lead an austere life with the masses, still perform poorly and lack the ability to develop a commodity economy and lead the masses to prosperity. They thus interfere with the development of the local economy and undermine the party's undertakings. When building grass-roots leading bodies, localities should introduce competitive mechanisms, and implement the principles of democracy, competition, and selection of the best. All localities should solicit opinions from the masses, respect the democratic rights of party members, and, on the premise of adhering to the policy of "four modernizations" of the cadres, particularly stress the principle of achieving practical results. Cadres who are faithful to the party's basic line, who have the reform spirit, and who have contributed to economic development should be selected and promoted to various leading posts. Let us build the leading bodies of grass-roots units into a strong center that offers leadership to the masses in the development of commodity production and in leading the masses to build the two civilizations.

Second, when recruiting party members, we should also follow the requirements of the basic line, pay attention to recruiting into the party outstanding youth with communist ideals and with the ability to lead the masses to prosperity. In accordance with different tasks and different historical periods, the party has set different requirements for party members. In the initial stage of socialism, the main task of the party is to develop social productive forces. Therefore, the main objective in recruiting party members should be adjusted accordingly. At present, there are many high school and middle school graduates in rural areas. They are young, educated, eager to learn, quick to accept new things, and

have a sense of urgency about developing a commodity production, shaking off poverty, and becoming well-off. Therefore, we should attach importance to training and educating them.

Third, we should improve the contents, methods, and style of educating party members. At present, we should closely combine ideological and political education among party members with the imparting of scientific, technological, and cultural knowledge as well as the skill to develop commodity production. Party members should consciously play the role of an advanced model as well as have the ability to lead the masses. We should combine education about lofty communist ideals among party members with education about the need to shake off poverty and become rich. This will help party members have lofty communist ideals, know the goals for struggle, and understand practical interests. The practical experience of jointly striving for prosperity by the party committee and the masses in Changtu County shows that at the present stage, if party members in rural areas do not have an understanding of the commodity economy and the skills to develop commodity production, they will not be able to take the lead and lead the masses to prosperity.

### **III. We Should Actively Explore New Ways To Bring the Role of Party Members and Party Organizations Into Play in the New Situation**

The role of party organizations as a fighting bastion and the role of a party member as an advanced model are very important. They are the basic guarantees for doing well in every aspect of work. The more we promote reform and the more we open China to the outside world, the more we have to bring the role of all levels of party organizations and party members into play. The success or failure of reform and opening to the outside world depends on the correctness of the party line, principles, and policies, as well as on the roles of our party organizations at all levels and all party members. Only by bringing into full play the exemplary role of all party members can the principles and policies of the party be implemented at grass-roots units, the masses be moved to do well in their work, and the task be fulfilled. Historical experience and practice over the past several

years in reform and opening to the outside world have shown that the advancement and victory we have achieved in our undertaking cannot be separated from the role of party as a fighting bastion and from the role of a party member as an advanced model. Political awareness and party spirit are needed to bring the role of a party member as an advanced model into play. At the same time, organizational activities are also required to bring into play the role of a party member as an advanced model. Party members in many areas are unable to fully give play to their exemplary roles. This has something to do with their lack of organizational activities. In order to fully bring the role of party members into play, we should, when educating party members, pay attention to studying and summing up ways and methods to enable party members to fully play their roles. We should also constantly improve the ways and methods in practice. Liaoning has tried and explored this area in recent years and has achieved certain results. Some of the main activities promoted in Liaoning are: the Striving for Common Prosperity Group by the party and the masses in Changtu County of Tieling City, the contest among party members and cadres to launch undertakings in Jinzhou District of Dalian City, the "three person contracted farming household" of Wafangdian City, the "party member responsibility group" of Haicheng City, the "party member group to serve the people" of Fengcheng County, the "four ones" in Hengren County, and the business services run by party members in Yingkou County. These activities are of major significance. They have created the necessary conditions for party members to give play to their roles, helped accelerate the elimination of poverty and becoming rich in rural areas, and promoted the development of the commodity economy in rural areas.

In the course of party building and when educating party members, we should treat the exploration of ways and methods to bring the role of party members into play as an important item on the agenda and study it. We should constantly sum up experiences in from practical work. We should sum up and promote ways and methods which can bring the role of party members into play, which are practical and acceptable to party members, and which we are able to put into practice so as to quicken the pace of party building and bring more benefits to the people.

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