

ACHIEVEMENTS AND CONTRADICTIONS IN CHINA'S ECONOMIC REFORM, 1979-88

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INTRODUCTION

THIS article analyzes at the macroeconomic level the background of China's economic reforms, their progress, and the contradictions arising out of them. In dealing with the background of these reforms, I will also refer to the old system that the reforms aimed to change, especially the contradictions in it that made the reforms necessary. Since economic reform in China means essentially the introduction of a market economy, the processes whereby such an economy was introduced into various fields of activity will be outlined. However, due to space limitation it is impossible to follow up and quantify later developments in market activity. Rather I will focus on those government decrees and laws introducing the market economy into specific areas of activity, assuming for the sake of convenience that these activities have been "marketized" with the enforcement of such a law or decree. In a vast country like China, government laws and decrees often fail to bring on immediate quantitatively significant results nationwide. Moreover, the market-economy policy has given rise to a host of altogether new contradictions, which will be covered in this article.

I. THE GROWTH OF ECONOMIC REFORM

First, let us compare the characteristics of the reform decade, which began in 1979, with the preceding twenty-five years of economic construction that started in 1953.

A. *Periodization*

The thirty-six years from 1953 through 1988, the year in which economic reform was frozen, can be divided roughly into two major periods—the first period covering 1953 through 1978 and the second period, our period of economic reform, 1979 through 1988. Using leaders' names as symbols, the first period can be termed the Mao Zedong period and the second the Deng Xiaoping period.

The first period also can be characterized as the period of primitive accumulation, which enabled modernization to take place. During that period a powerful capital-accumulation process was set into motion in order to unify and industrialize the national economy by overcoming regional division. This task was carried out under difficult international circumstances, in which China, faced with a 90 per cent illiteracy rate and seeing 60 per cent of its citizens starving, had to militarily

confront the United States (and later the Soviet Union). China under these circumstances had to create a system that could constantly increase the share of national income appropriated for accumulation. For this purpose, the peasantry, representing 85–90 per cent of the population, was mobilized practically without compensation for their labor, to build irrigation systems and roads, and conduct forestation projects. Accumulation was achieved by labor creating a national infrastructure. The system that made this type of accumulation possible was the people's commune, and the economy during that period can be called "investment-oriented."

However, early in the 1970s the personal income of urban dwellers and suburban peasantry began to increase, requiring a new resource-distribution policy to satisfy the demand arising out of such prosperity. The end of the Vietnam War in May 1975 strengthened the need for such a policy change, and in fact worked as one source of pressure for a new economic system.

Two immediate factors compelled the investment-oriented economy to change dynamically. One was the pressure from the countryside, and the other the impact of the return to cities of the 20 million rusticated young people.

In 1979 the government raised the purchase price of agricultural products by a drastic 24 per cent. The portion of farm products sold to the government in excess of quota were bought at a 50 per cent higher premium price. Furthermore, the government drastically eased restrictions on free markets, liberalizing the food products trade. Thus, a dual price system was introduced for primary agricultural products. Peasants sought to sell their products at as high a price as possible. This fast undermined the government's control on agriculture and also led to the collapse of the people's commune system, the system through which government control had been exercised. The rise in agricultural prices and the collapse of the people's commune significantly changed the income distribution pattern in favor of the peasantry, causing agrarian income to soar.

Rusticated youth rushed back to the cities in 1978 and 1979. The cities, whose population totaled 170 million in 1977, saw an influx of 20 million people during those two years. Given the fact that one-third of the urban population were already suffering from housing difficulties, the sudden arrival of 20 million new residents naturally exacerbated the housing problem. The government had to allocate resources preferentially for house construction. This forced the traditional urban resource allocation pattern to change.

In the few years after 1979, the Chinese economy thus had to shift to a consumption-oriented model. Though the capital-accumulation rate again began to rise in 1985, a new resource allocation pattern had already set in and the old pattern never returned. The emphasis of resources allocation shifted from the Mao Zedong period's military-industrial oriented heavy industries to house construction and new heavy industries geared toward civilian demand.

B. Ten Years of Economic Reform, 1979–88

The period of economic reform, which began in 1979, may be divided into a first stage (1979–84) and a second stage (1985–88). The first centered on

economic reform in the countryside. During that stage only preparatory measures were taken concerning reforms in state enterprises located in urban areas. During the second stage the emphasis was shifted to urban reforms, in the recognition that rural reform had been more or less successfully completed. During this stage the commercialization of the various production factors was carried out. Figure 1 gives a general picture of these reform processes.

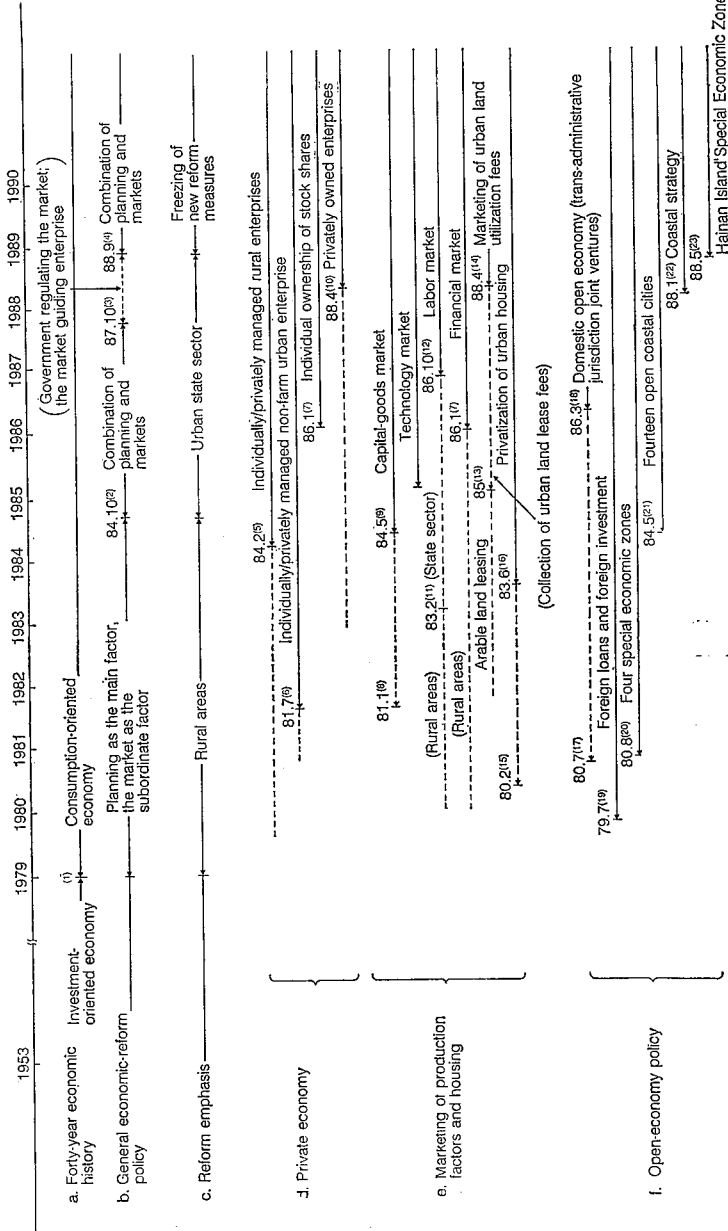
The Communist Party of China characterized its policies for the first and second stages as follows. During the first stage, the key phrase was "economic planning is the main factor and markets the subordinate factor" and during on the second stage it was "a combination of economic planning and markets." The Thirteenth National Congress of the Communist Party of China held in October 1987 decided that future policy should feature "the government regulating the market and the market guiding enterprise." The Chinese economy would have entered a third stage if this policy had been fully implemented; but the surfacing of serious contradictions, implied by inflation in 1988, compelled the Chinese government to freeze the new policy. The current policy is still in the second stage, namely, one of "combining planning with the market."

The rural reform implemented during the first stage boils down to the dissolution of the people's commune and the introduction of an "individual farm" system.¹ The people's commune system consisted of two essential elements. One was the integration of political power and economic management; the second was the (1) public ownership of agrarian land and other means of production, (2) organizing labor into a communal work force, and (3) preferential allocation of income for public use with the remaining portion distributed to individuals. The essential aspects of the people's commune were modified through the reform that began in 1979. The land ownership and utilization rights, as well as non-land means of production were separated and the agrarian household was turned into the unit of farm management. With this change, the farm household became able to appropriate the labor of its members at its own discretion. It also obtained the right to dispose of its products over and above the portion delivered in agricultural taxes and sold to the government on a contract basis. This reform also opened the way to the development of a private sector, including private merchants, industrialists, and private firms (employing eight or more workers).

In the urban setting some state enterprises were selected to test the new management methods of expanded enterprise autonomy and partial contract-based production. Traditionally state enterprises received all necessary funds, materials, and labor from the government and paid almost all its earnings back to the government. At selected enterprises new formulae were tested, such as bank loans instead of government funding, giving enterprises not only the right to choose and buy materials freely instead of depending on government allocation, but also the right to sell some products freely, and allowing the enterprises to retain a

¹ In China this system is called the responsibility system for agricultural production (*nongye shengchan zerenzhi*), but here I will refer to it as "individual farm" system. I put the term in quotes because legally speaking the all cultivated land is collectively owned, the user having no right to dispose of it freely.

Fig. 1. The Ten-Year History of Reform and Open Economy



Sources: (1) Resolution of the Third Plenary Session of the 11th Central Committee of the Communist Party of China (*Xinhua yuebao*, 1978, No. 12); (2) Resolution of the Third Plenary Session of the 12th Central Committee of the Communist Party of China (*Xinhua yuebao*, 1984, No. 10); (3) Zhao Ziyang's report to the Thirteenth National Congress of the Communist Party of China; (4) Zhao Ziyang's report to the Third Plenary Session of the 13th Central Committee of the Communist Party of China (*Xinhua yuebao*, 1988, No. 10); (5) "Guowuyuan guanyu nongcun getihu gongshangye de ruogan guiding" [Provisions of the State Council for private enterprises in rural areas] *Xinhua yuebao*, 1983, No. 3, pp. 123-24; (6) "Guowuyuan guanyu chengzhen feinongye geti jingji

ruogan zhengcexing guiding" [Policy regulations of the State Council for the urban non-farm private economy], in the State Planning Commission, *Zhongyao jingji fagui ziliao xuanbian, 1977-1986* [A collection of important economic laws, 1977-86] (Beijing: Zhongguo-tongji-chubanshe, 1987), pp. 3-4; (7) "Guojia tigeiwei, Zhongguo Renmin Yinhang guanyu shenhua jinrong tizhi gaige shidian de bushu" [The plan for trial models of the State Commission for Restructuring the Economic System and the People's Bank of China to enhance banking system reform], in *Jingji tizhi gaige shouce, xu I* [Handbook for restructuring economic reform, sequel no. 1], ed. Zu Yuanzhen and Fan Maofa (Beijing: Jingji-ribao-chubanshe, 1989), pp. 174-77; (8) "Guowuyuan pizhuan Guojia jihua weiyuanhui deng bumen 'guanyu gongyepin shengchan ziliao shichang guanli zanzing guiding' de tongzhi" [State Council's approval of the interim provisions to supervise the marketing of industrial production goods by the State Planning Commission and others], in *Jingji tizhi gaige shouce* [Handbook for restructuring economic reform], ed. Wang Jiye and Zhu Yuanzhen (Beijing: Jingji-ribao-chubanshe, 1987), p. 201. (9) "Guowuyuan ganyu jin'yibu kuoda guoying gongye qiye zizhuquan de zanzing guiding" [Interim provisions of the State Council for expansion of the autonomous powers of state industrial enterprises], *Xinhua yuebao*, 1985, No. 5, pp. 129-30; (10) "Guowuyuan ganyu zhishu zhuangang de zanzing guiding" [Interim provisions of the State Council for technology transfer], in the State Planning Commission, *Zhongyao jingji fagui*, pp. 1023-25; (11) "Laodong renshibu guanyu jiji shixing laodong hetongzhi de tongzhi" [Notice of the Ministry of Labour and Personnel on the positive attempt at the working contract system], in *Jingji tizhi* (1987), pp. 373-74; (12) "Guoying qiye shixing laodong hedongzhi zanzing guiding" [Interim provisions for introduction of the working contract system into state enterprises], in *Xinhua yuebao*, 1986, No. 9, pp. 39-40; (13) Li Ning, "Chengshi tudi guanli zhidu shang de yixiang tupo" [A new step on land management in cities], *Chengxiang jianshe*, 1985, No. 7, p. 17; (14) Zhonghua-ren-mingongheguo xianfa xiuzheng caoan" [A revised draft of the Constitution of the People's Republic of China], *Xinhua yuebao*, 1988, No. 4, p. 37; (15) Deng Xiaoping, "Guanyu jianshuye he zhuzhai wenti de tanhua" [Statement on the construction industry and housing problems], in *Zhongyao jianzhu nianjian, 1984-85* [China building almanac, 1984-85], (Beijing: Zhongguo-jianzhu-gongye-chubanshe, 1985); (16) "Chengzhen geren jianzao zhuzhai guanli bianfa" [Procedures for management of urban private residences], *Xinhua yuebao*, 1983, No. 7, p. 116; (17) "Guowuyuan ganyu tuidong jingji lianhe de zanzing guiding" [Interim provisions of the State Council for promotion of cooperation among enterprises], in the State Planning Commission, *Zhongyao jingji fagui*, pp. 62-63; (18) "Guowuyuan ganyu jin'yibu tuidong hengxiang jingji lianhe ruogan wenti de guidong" [Provisions of the State Council for the further promotion of horizontal cooperation among enterprises], in the State Planning Commission, *Zhongyao jingji fagui*, pp. 150-54; (19) "Zhonghua-renmingongheguo zhongwai hezi jingying qiye fa" [The Law of the People's Republic of China on Chinese-Foreign Joint Ventures], in the State Planning Commission, *Zhongyao jingji fagui*, pp. 1088-90; (20) "Guangdongzheng jingji tequ tiaoli" [Regulations on Special Economic Zones in Guangdong Province], in *Jingji tizhi* (1987), pp. 388-90; (21) "Guowuyuan youguan fuzeren jiu jin'yibu kaifang yanhai shisi ge chegshi de ruogan chengce da Xinhuashe jizhe wen" [The responsible person of the State Council answers questions raised by a reporter of the China News Agency on the policy problems to further open fourteen coastal cities], in *Jingji tizhi* (1987), pp. 388-90; (22) "Zhao Ziyang zongtan yanhai diqu jingji fazhan zhanlue" [General Secretary Zhao Ziyang talks freely on the economic development strategy of the coastal regions], *Xinhua yuebao*, 1988, No. 1, pp. 45-48; (23) "Guowuyuan guanyu guli touzi kaifa Hainandao de guiding" [Provisions of the State Council for encouragement of investment on Hainan Island], *Xinhua yuebao*, 1988, No. 1, pp. 67-68.

certain portion of its sales instead of transferring the whole amount to the government.

Within the government fiscal system, local authorities at different levels were given the right to retain certain portions of their revenue, if they succeeded in either increasing revenue or cutting expenditures.

During the second stage of economic reform, the emphasis was shifted to reforming state enterprises using generally the same methods tested on selected enterprises during the first stage. Thus, the traditional system under which the government gave directives on production targets to each enterprise and provided them with all necessary factors of production was gradually replaced by a new system under which the factors of production could be obtained by state enterprises, through the market mechanisms.

Figure 1 shows exactly when marketing of each production factor was officially enforced. The factors that were left to the market included finance, labor, materials, capital equipment, technology, and land. The broken lines in Figure 1 show experimental periods. Take labor for example. In 1983, a contract system for employment in state enterprises was introduced for the first time starting in Guangdong Province. This contract system has been adopted by all state enterprises across the country since October 1986.

Figure 1 shows that the factors of production began to go on the market one after another around October 1984 when the Third Plenary Session of the 12th Central Committee of the Communist Party of China decided to shift the reform emphasis to urban state enterprises. That marked the beginning of full-scale economic reform in urban centers.

The capital-goods market. Capital goods used to be distributed by the State Bureau of Supplies and did not enter commodity distribution except when going to the countryside. In other words, there was no capital-goods markets in urban areas. In May 1984 the State Council promulgated "Regulations for further expansion of the autonomous powers of state enterprises." These regulations permitted state enterprises to sell freely their extra-quota products, new test-manufactured products, and up to 2 per cent of their quota-covered outputs. The state enterprises were also permitted to adjust the prices of their freely sold products within 20 per cent of the official prices. In actual practice, capital goods were already being traded in kind at prices fairly higher than the official prices even between state enterprises not singled out for reform experiments. The new regulations could therefore be interpreted as a measure to officially recognize what was already being practiced. However, the State Council regulations probably should be considered even more significant in that fact that they represented official approval for the establishment of a capital-goods market.

The market for technology. Before 1978 technology was not considered a tradable object under government policy. "Regulations for the promotion of inventions and scientific discoveries" were issued twice in the 1950s and again in the 1960s and 1970s, but there was no idea of a patent in China. These regulations simply stated that those who have made epoch-making inventions should be rewarded with promotional money based on the amount of profit stemming from

their application. For the Chinese government to realize that technology is also a commodity, it required the whole experience of trying to introduce technology from Western countries. Capitalist enterprises asked for royalties for the technology China wanted to introduce. Until the 1970s China was not willing to pay even for the patented know-how, let alone for software; but it had to realize soon that not paying prices for software and patented technology would prevent the introduction of advanced technology. Therefore, China instituted its 1984 Patent Law and subscribed to the International Convention for the Protection of Industrial Property. Under mounting international pressure, the State Council in January 1985 enacted "Interim provisions for technological transfer," whereby a technology market was finally opened in China.

The labor market. The market for labor completely disappeared in the People's Republic in 1958. In the cities ordinary citizens seeking jobs registered with their street committees, the lowest echelon in the government structure, and then the government labor administration office would unitarily assigned them to different jobs. College and middle-school graduates would be assigned to jobs by their schools on the basis of instructions given by the government labor administration offices. No rural residents were allowed to work into the cities without the approval of the party secretary at their people's commune and a recommendation from an employer. There was no freedom of job selection or place of residence. Nor had enterprises the freedom to hire personnel.

Changes occurred in the 1980s first at the Shenzhen Special Economic Zone. Foreign investors setting up their plants there demanded the right to hire personnel, and the Chinese government had to concede to this demand. And so, the traditional life-time employment practice was replaced by a contract system. The government also accepted management's right to dismiss personnel.

Another change occurred in the countryside. After the dissolution of the people's commune, local enterprises mushroomed in small rural towns all over the country. These enterprises hired workers on more or less "free" labor markets. Given this development, the State Council promulgated "Interim provisions for the implementation of the contract labor system" in July 1986, providing that all fresh hiring as of October 1 that year should be on a contract basis. The enterprise also was given the right to hire workers. Individuals were thus granted the right to select jobs and enterprises.

The financial market. Prior to 1978 China's financial institutions were doing only bookkeeping and deposit handling. Loan operations were limited to small-scale lending of excess cash funds. Financial reform was aimed at imparting entrepreneurship to such banks and thus creating a financial market.

In the same way as the labor markets, financial markets emerged first in the countryside, in the form of usury during 1980-81. The government however did not take any effective measures to curb these practices. As far as the legal aspect is concerned, the "Interim regulations governing banks of the People's Republic of China" issued in January 1986 banned banking operations by individuals, but in practice fairly free financial markets have been in operation up to the present day.

In the cities, inter-bank short-term financial markets have been established one after another since 1986 in a number of different provinces, however, there was no long-term financial market. Foreign exchange markets were introduced in 1986 in several cities. Against this backdrop, policy-makers began to discuss in 1987–88 the establishment of a national financial market. Until reform was frozen in the fall of 1988, debate continued on the establishment of stock and securities markets as well as the reorganization of state enterprises into joint-stock companies.²

The land market. Before 1978 cultivated land was owned by the village, and urban land, major mountain areas, rivers, and lakes were owned by the state. When people's communes were dissolved, many farmers misunderstood the land utilization rights conferred upon them as private land ownership, and in many cases arable was bought and sold. The government, however, has never allowed land to be privately owned.

Concerning urban land, the government has in practice commoditized it by separating land utilization rights from land ownership rights and making utilization rights marketable. Since land has no price, many state enterprises, schools, and organizations connected to strong and influential party secretaries have been able to secure large tracts of surplus land and keep them idle. To rectify this negative practice, Fushun City in 1985 began to collect ground rent from such land. This case stimulated a nationwide debate and several cities dared to follow suit in introducing ground rent systems. In the Shenzhen Special Economic Zone demand for land suddenly took off, and the local authorities responded by trying open bidding on land in the style of the Hong Kong system. In Hong Kong, the land is owned by the British royal family, but its utilization rights for a specified period of time are marketable. It is this same system that was followed in Shenzhen. After years of deliberation, "Interim regulations concerning the transfer and re-transfer of urban state-owned land utilization rights" was finally promulgated in May 1990. Under the new regulations, urban land utilization rights in China have become marketable through open bidding and/or auction. The utilization rights for residential land are valid for seventy years, while those for industrial land may last for fifty years.

The privatization of cultivated land ownership was hotly debated during 1987 and 1988. A number of scholars, particularly younger ones, argued for privatization, but they have been silenced since the Tiananmen Square Incident (April 16–June 4, 1989).

The residential housing market. Residential houses are not a factor of production; but in a socialist society whether a house can be privately owned or not is a serious theoretical and economic policy issue. For example, how can it be theoretically consistent that a house built on nationalized land is privately owned? If it is a privately owned house, it can be rented to somebody else for a fee. Rent

² A national conference was held in August 1988 at Shenyang to promote the transformation of state enterprises into joint-stock companies and the establishment of stock and securities markets. Most of the participants supported the idea. (Zhe Yong "You jihua di tuixing qiye gufenzhi" [Let us promote the transformation of state enterprises into joint-stock companies on a well planned basis], *Xinhua yuebao*, 1988, No. 11, pp. 70–72.)

goes against the socialist principle that there shall not be unearned income. Moreover, can real estate be inherited? In the area of policy, private house ownership involves a whole range of problems pertaining to construction, distribution, marketing, consumption, and maintenance. These issues span a broad economic area as well as the household-economy sector. Policy-wise, it seems impossible to privatize only one element in such a long chain of interrelated aspects.

Like in other socialist countries, private ownership of houses in urban areas has never been permitted in China. All these houses have been built by the government (in practice by state enterprises, organizations, and government agencies) and rented to the employees at low rates. The monthly rent has often been as low as the price of a pack of high-grade cigarettes. Under this system the more urban houses that are built, the larger is government financial burden. During 1978–79 the massive return of rusticated youth necessitated larger housing programs, resulting in larger deficits in state coffers. Faced by this situation, the government in June 1983 had to promote private home building by enforcing “Procedures for the control of urban private home building.” In addition, the government decided to sell existing houses to private persons.

The above is an outline of how and when major decisions were made to allow markets for the main factors of production and housing. After the thirteenth party congress, the government was already prepared to go a step further to tackle the most difficult of the reform tasks, price reform. It seems that the government was also preparing for wage reform. Expansion of the production factor markets and reform of the price system would require change in the ownership system. During 1987–88 heated debate continued over the privatization of farm land and the transformation of state enterprises into joint-stock companies (i.e., the private ownership of stock shares). This debate seems to have had a profound effect on the deliberations of the thirteenth party congress general policy, namely, the formulation of “the government regulating the market and the market guiding enterprise.” In this author’s understanding, this general policy was to prepare for a transition in economic reform from the second to the third stage; but it was precisely then that inflation raised its ugly head, forcing the government to freeze all new reform measures and to begin all-out effort to curb inflation. Politically, the reformists fast lost their voice following the 1989 Tiananmen Square Incident. As a result, the Li Peng administration still seems to be following the stage-two reform policies, unable to take any further steps.

C. Open-economy Policy

The open-economy policy is one of the two major facts of the post 1979 reform program. The open-economy policy has in turn two major aspects: opening up the economy internally and externally. The external aspect is already well known, so I will not go into details about it. Figure 1 will give the reader an idea about its development over time.

The domestic aspect seems to require a little more explanation. One of the contradictions generated during the Mao Zedong period (1960s and 1970s) was

known as *tiaotiao kuaikuai* (the contradiction between the vertical and the horizontal). What this indicates is a set of contradictions arising from sectionalism between vertically organized and horizontally organized bureaucracies. There are two lines of command in China. One is the vertical (*tiaotiao*) line along which directives go from central government offices to corresponding local government offices. Each ministry thus keeps its exclusive line of command, without any outside interference from other ministries. The structure thus built is like a group of independent kingdoms. The local governments as such are not permitted to meddle in this administrative territory. On the other hand, each local government has a complete, exclusive monopoly over affairs within its jurisdiction. No other local governments can interfere, nor can the vertical command line of central government offices easily penetrate it.

For example, in railway operations locomotive must be changed if a train crosses jurisdictional borders. Rivers are divided into jurisdictions under different offices, meaning that a freighter belonging to one government office is not allowed to enter the jurisdiction of another office, thus cargo has to be reloaded onto a new ship before crossing the boarder. There are numerous cases of such occurrences. An enterprise owned by the Shanghai municipality is not permitted to set up a subsidiary or even a branch office in Wuhan City, because it is outside of Shanghai's jurisdiction. In the disposal of pollutants, the environmental protection office of the Ministry of Metallurgical Industry is not able to work jointly with the environmental office of the Ministry of Chemical Industry. Breaking such barriers was one goal of the domestic open-economy policy. For example, in order to enable a Shanghai municipal enterprise to work together with a Wuhan enterprise, factors of production must be allowed to move beyond administrative jurisdictions. This in turn requires the development of markets for the factors of production.

The State Council in March 1986 enacted "Regulations to promote horizontal collaboration among enterprises." This directive provided for the removal of barriers between the vertical and horizontal administrative structures, between industries, between enterprises of different modes of ownership, and between capital-goods enterprises and the processing enterprise. It also encouraged the management of munitions enterprises for civilian purposes.

II. ACHIEVEMENTS OF THE REFORM DECADE

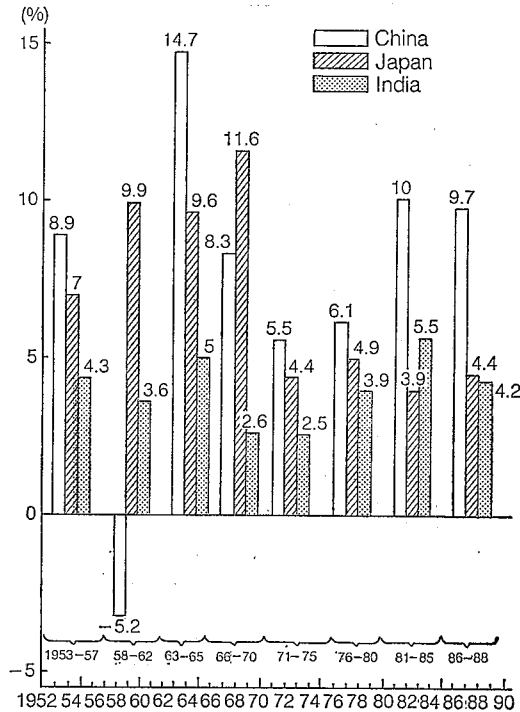
The following three points are considered the positive macroeconomic achievements of China's economic reforms.

A. *High Economic Growth on a Stable Basis*

Figure 2 shows the annual economic growth rates of China, Japan, and India in real terms. The five-year scale corresponds to the China's five-year plan. The diagram clearly shows China's growth rate as very unstable before 1975, then stabilizing from around 1980. Also the economy maintained a super-high average annual growth rate of 9.2 per cent during the 1979-88 period.

The definition of high growth may differ depending on the expert. My definition is based on the appraisal of economic performance in Japan and other countries,

Fig. 2. Annual GNP Growth Rates in Real Terms

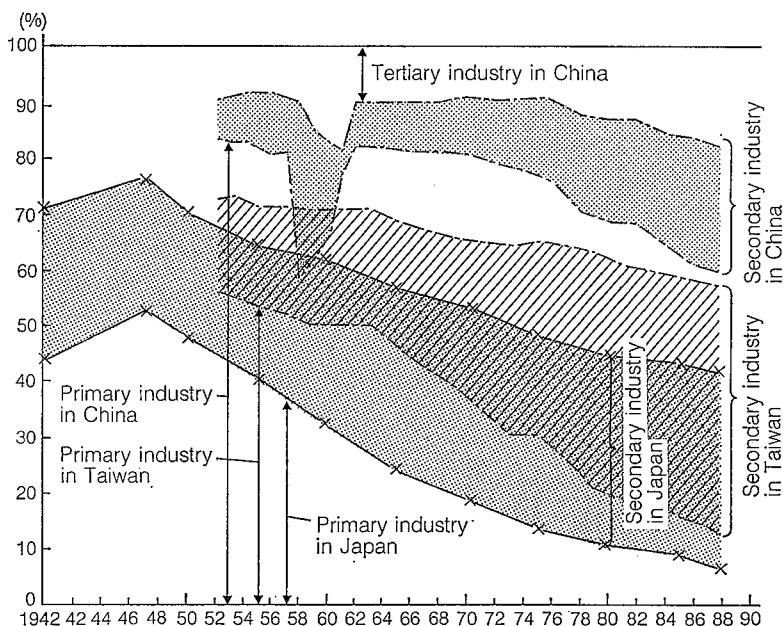


Sources: For China, calculated from [1, 1989 edition, p. 30]; for Japan, [3, pp. 95-96] and, for 1985-88, Japan, Economic Planning Agency, *Kokumin keizai keisan nempō* [Yearbook of national accounts], various editions; for India, Government of India, Ministry of Finance, *Economic Survey, 1988-89* (1988), p. S-3.

Note: For China, *guomin shouru* (national income) is used. This approximately equivalent to the United Nations' "net material product."

regarding less than 4 per cent as "low growth," 4-6 per cent as "normal growth," 6-8 per cent as "high growth," and above 8 per cent "super-high growth." This formulation is for economies that have not yet reached their mature stages. Therefore, the above does not apply to mature economies since the ranges are too high. The Japanese economy started to grow rapidly in 1957-58 and continued to realize surprisingly high growth rates on an annual average of 10.6 per cent for the subsequent fifteen years until the first oil crisis in 1973. This is why Japan's readings are very high from 1958 through 1970 in Figure 2. Taiwan grew most rapidly from 1964 through 1978, or at an annual rate of 10.3 per cent. The

Fig. 3. Industrial Structure by Sector



Sources: For China, [1, 1989 edition, p. 105]; for Japan, [3, p. 57] and, for 1986–87, Yano Tsuneta kinen-kai, ed., *1989-nen Nihon kokusei zue* [Illustrated state of Japan, 1989] (Tokyo: Kokusei-sha, 1989) p. 87; For Taiwan, [2, p. 16].

Note: China's tertiary industry does not include administrative, military or police service; the figure is thus a minimum sum.

China's average annual growth rate of 9.2 per cent during the ten years since 1979 well compares with the Japanese and Taiwanese rates. It is important to note that China is an economy of one billion people unlike the 100 million of Japan or 15 million of Taiwan. It should also be emphasized that such a high growth rate was achieved in a country with a land area twenty-seven times that of Japan. There are a number of regions in China, each with the land areas equal in size to Taiwan or the Republic of Korea, that achieved annual growth rates between 13 and 14 per cent. This one of the major reasons why the serious contradictions to be discussed in the following section emerged.

To discuss economic growth in a vast country like China, it may be appropriate to compare it with India. The Indian economy in the same five-year period grew only at a low rate or just above that rate according to my definition.

B. Changes in Industrial Structure

Figure 3 shows changes in industrial structure in terms of the number of employees in different sectors. On the Chinese continent the percentage of primary-

industry employees in the work force began to decline from 80.7 per cent in 1970 to 70.7 per cent in 1978. During the subsequent nine years the figure dropped again from 70 per cent to 60 per cent.

Ignoring for the time being differences in the stage of economic development, let us compare China's percentage of primary-industry employees with those of Japan and Taiwan. For Japan a drop of 10 points from 40 per cent to 30 per cent took seven years (1956 to 1962) and the next drop of 10 points from 30 per cent to 20 per cent took another seven years (1963 to 1969) [3, pp. 56–57]. In Taiwan, the figure fell from 50 per cent to 40 per cent over eight years (1961 to 1968) and then dropped to 30 per cent over the next seven years (1969 to 1975) [2, p. 16]. Both in Japan and Taiwan the signal contraction of the primary-industry labor force occurred in the midst of super high growth. Does the drop of the Chinese primary-industry employees from 80 per cent to 70 per cent from 1971 through 1978 then indicate that the Chinese industrial structure changed as drastically as in Japan and Taiwan during their super-high growth periods? The answer is negative. In Japan and Taiwan, urban industries were able to absorb most of the farmers who had left their villages and agriculture; but Chinese urban industries failed to do so during its period of contraction. Migration from the countryside to the cities was prohibited by various administrative measures. Therefore, those who quit agriculture were forced to stay in the countryside. This surplus labor force was retained in the rural areas in various ways. The return of rusticated youth to the cities in 1978–79 broke this bottleneck.

The economic reform which began in 1979 also opened the way to absorbing the surplus labor force of the countryside into the village and township enterprises (*xiangzhen qiye*) and after 1983 into the cities. Both resulted from the collapse of the people's communes. The people's commune had been a social device for containing an expanding rural population in the countryside. Also, it effectively prevented labor, technology, and money moving from one people's commune to another. As the result of the reforms, these factors began to flow freely between former people's commune jurisdictions, and this contributed to the rapid development of village and township enterprises. Workers employed by village and township enterprises numbered 28 million in 1978, increased to 32.35 million in 1983, the year the people's communes were reorganized, then to 52.1 million in 1984, and further in 1988 to 95.45 million, or a quarter of China's rural labor force. Restrictions on the movement of seasonal migrant workers from the countryside to the cities were also eased in 1984, causing a vast number of peasants to go to urban areas in search of jobs. Table I gives some data about labor force migration in 1984.

Overall, the Chinese industrial structure improved in the following sense. In the 1970s industrial structure changed in such a manner as to generate unabsorbed surplus labor force in the countryside, but in the subsequent decade the development of various industrial sectors in the countryside absorbed much of the surplus rural labor, while cities also functioned to absorb surplus labor in the form of seasonal migrant workers.

TABLE I
CASES OF MIGRATION OF RURAL POPULATION IN 1984

Province	Year	Content	Source
Jiangsu	1984	200,000 seeking work in other provinces and 400,000 to places within their home provinces (126 sought work in other provinces for the first time in 1979)	ZXQB, April 6, 1985
Henan	1983	1,000,000 to other places in and outside of the province, 200,000 of them to other provinces	RMRB, April 3, 1984
Hebei	1984	500,000 to Beijing and Tianjin for construction work	RMRB, April 17, 1985
Henan	1984	210,000 to 21 other provinces and cities	ZXQB, April 13, 1985
Zhejiang	1984	1,700,000 peasants to tertiary industry	ZXQB, March 30, 1985
Guangxi	1984	More than 300,000 peasants to service and construction industries	ZXQB, April 3, 1985
Shanxi	1984	260,000 peasants to tertiary industry	SRB, December 18, 1984
Jiangsu	1983	Rates of peasant transfer to nonagricultural businesses: 36% in Wuxi County, 30% in Jiangyin County, and 46% in Shazhou County	BR, 1984, No. 35

Notes: ZXQB—*Zhongguo xiangzhen qiye bao*; RMRB—*Renmin ribao*; SRB—*Shanxi ribao*; BR—*Beijing Review* (Japanese edition).

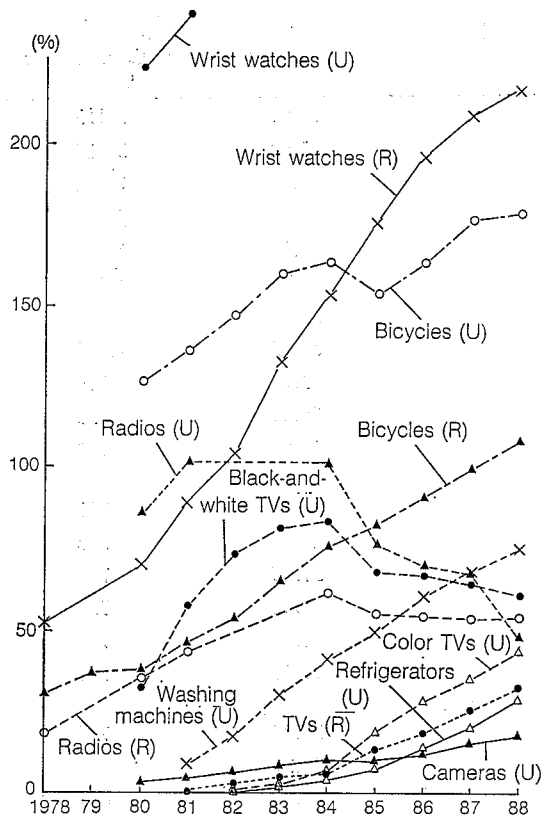
C. Increases in Personal Income, Especially Agricultural Income

The major achievement of the economic reforms was that it significantly increased the income of the peasantry, the stratum of people who had up until that time benefited least from economic development. Peasant household income jumped as a result of (1) successive rises in government purchase prices of agricultural products beginning in 1979 and (2) a reduction in the amount of farm products dutifully sold to the government on a contract basis (i.e., an increased number of products freely sold by farmers). The nominal average wage per capita of urban workers in 1988 was 2.85 times that of 1978. While the average net income per peasant increased 4.07 times [1, 1989 edition, p. 719].

As this figure illustrates, the living standard of the peasantry rapidly improved. Already in the 1970s most peasants, with the exception of 80 million in the poorest stratum, had basically sufficient supplies of food and clothing. In the 1980s peasants, particularly those in suburban areas, began to enjoy a more prosperous life. Diffusion rates of consumer durables may be taken as an indicator of their standard of living (see Figure 4). Television sets began to be owned by urban families in 1979–80, and by 1985–86 80 per cent of urban households owned one. Rural TV-set ownership lagged by five years.

China does not provide an integrated standard of living index, but it can be safely said that at least one-third of all rural families enjoy better housing conditions

Fig. 4. Diffusion Rates of Consumer Durables (Household as the Unit)



Sources: [1, 1984 edition, p. 466] [1, 1986 edition, p. 676] [1, 1989 edition, pp. 728, 745].
 Note: U—Urban, R—Rural.

than the average urban family. A home construction boom began in 1978 in the suburban rural areas and is still continuing today.

This does not mean, however, that the standard of living in rural areas has uniformly risen. As a matter of fact, regional disparities have widened. Table II shows regional differences in TV-set diffusion rates in the countryside. It also gives domestic material output values in different provinces, cities, and autonomous regions. Shanghai has the highest per capita domestic material output value of 3,816 yuan, 8.2 times Guizhou Province the lowest at 465 yuan. The household income gap does not parallel the output value gap since the government comes out income redistribution, but TV-set diffusion rates indicate large regional gaps:

TABLE II
TV-SET DIFFUSION RATES IN RURAL AREAS

First-level Regional Administrative District	Population (Million)	Net Domestic Material Output per Capita, 1987 (Yuan)	TV-set Diffusion Rates in Rural Areas, 1988 (%)
Beijing	10.81	2,413	85.73
Shanghai	12.62	3,816	90.00
Tianjin	8.43	2,264	79.46
Liaoning Province	38.20	1,510	65.79
Jiangsu Province	64.38	1,251	35.19
Zhejiang Province	41.70	1,241	36.83
Heilongjiang Province	34.66	1,136	43.96
Guangdong Province	59.28	1,098	33.75
Jilin Province	23.73	1,016	60.13
Shandong Province	80.61	935	38.29
Hubei Province	51.85	925	37.72
Xinjiang Uygur Autonomous Region	14.26	853	22.82
Fujian Province	28.45	815	33.24
Hebei Province	57.95	791	43.81
Qinghai Province	4.34	756	25.00
Hainan Province	6.28	746	—
Shanxi Province	27.55	707	34.47
Inner Mongolia Autonomous Region	20.94	701	29.56
Hunan Province	58.90	699	20.60
Anhui Province	53.77	681	22.38
Ningxia Hui Autonomous Region	4.45	664	48.71
Hunan Province	80.94	641	15.43
Gansu Province	21.36	631	19.50
Jianxi Province	36.09	619	24.33
Shaanxi Province	31.35	607	18.83
Sichuan Province	105.76	602	25.60
Tibet Autonomous Region	2.12	598	1.26
Yunnan Province	35.94	525	13.58
Guangxi Zhuang Autonomous Region	40.88	519	16.48
Guizhou Province	31.27	465	8.17

Source: TV diffusion rates are calculated according to figures from [1, 1989 edition, p. 753] and by estimating household numbers from population statistics [1, 1989 edition, p. 89]. Net domestic material output figures come from [1, 1989 edition, p. 33].

90 per cent in Shanghai's suburbs compared with 1.26 per cent for Tibet and 8.2 per cent for Guizhou Province.

Despite these widening disparities, the peasantry on the whole reached, at the middle of the 1980s, a new standard of living in which they were able to own consumer durables. This is the most important point to be made here.

III. FIVE MAJOR CONTRADICTIONS

The achievements mentioned above have in turn generated five major contradictions. It is these contradictions that in turn generated inflationary trends in 1988, causing hoarding by urban residents and runs on banks. Consequently, the Chinese government had to freeze its economic reform program at its second stage of development. This is the situation today.

A. *Sustained Economic Heating*

Generally, this is considered to be a phenomenon caused by an excess of gross demand over gross supply. Gross demand is composed of consumption, enterprise investment, government spending, and exports.

Consumption is composed of personal consumption and collective consumption, meaning spending by enterprises, organizations, and government agencies for their employees. As was mentioned earlier in this article, the government was compelled to hammer out economic reform policies under pressure of rapid increase in personal consumption by the urban population and suburban peasants. The general rise in the peasant income and revived promotional bonuses for urban workers contributed to further expansion in personal consumption. Collective consumption also burgeoned as enterprise managers, having been given more autonomous powers, increased spending in cash and in kind for their employees.

Gross investment increased as enterprises and local governments engaged in investment drives. This, too, resulted from the economic reforms. Before 1978 there was practically only one investing body, the central government's State Planning Commission. As the result of reform, China came to have four investing sectors instead of one. They are the State Planning Commission, central government agencies, local governments, and state enterprises. The latter three emerged as the major investors replacing the planning commission.

Two reform programs brought this situation about. One was a new system enforced to enable central government agencies, state enterprises,³ and local governments to retain internally large amounts of funds that would have formerly been remitted to the central government. These retained funds are called "extra-budget" funds. The total of these funds grew from 34.7 billion yuan in 1978 to 202.9 billion yuan in 1988, a 680 per cent increase. They were equal to 31 per cent of the government budget in 1978, and grew to as large as 90 per cent in 1988. Using these funds, central government agencies, state enterprises, and local governments began to set up new businesses and make extra-plan investment.

³ Business behavior during the reform has been analyzed by Kyōichi Ishihara in his article which also appears in this special issue.

Secondly, there is the banking system reform that brought about an expansion in investment opportunities. The banks used to be just bookkeepers of government finances, making only meager investments on their own discretion in state enterprises and local governments. This system was changed so that local governments and enterprises could borrow money for plant and equipment. Local governments often exerted pressure on banks to extend loans for the promotion of economy in their jurisdictions. The investment overheat in 1984–85 was caused by this.

The long lasting economic overheating thus generated gave rise to an excess demand for raw materials, fuels, and transportation, all of which were in relative short supply, and led to inflation.

B. *Deficit Budgeting and Spiraling Inflation*

During the period of the Kuomintang rule, the government issued too many deficit bonds, causing runaway inflation and undermining its own position. Aware of this danger, the Communist party had consistently called for balanced budgeting from the time of the founding of the People's Republic of China. However, since 1979, the government has become involved in deficit budgeting (Figure 5). The budget deficits incurred in during the first three years are understandable, since the government raised its purchase prices for agricultural products and also had to pay off for liabilities generated during the Cultural Revolution. But budget deficits during subsequent years were structural deficits generated by economic reform itself.

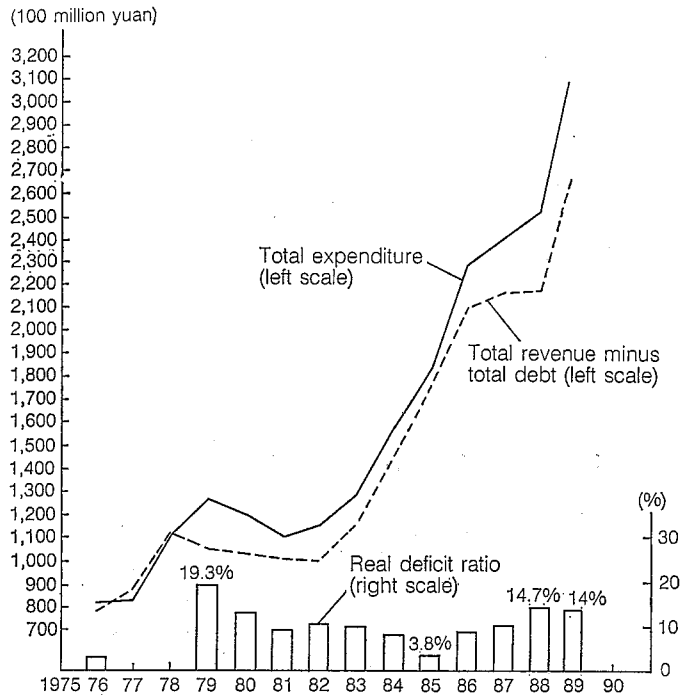
Government revenue became top-heavy. First, the central government allowed local authorities and state enterprises to retain too much out of their earnings. Secondly, state enterprises were unsuccessful in increasing productivity, as 20 per cent of them suffered losses, thus failing to contribute to the central government coffers. On the expenditure side, government outlays grew initially because of the repeated hikes made in the purchase prices for agricultural products and the various subsidies paid to agriculture. Then the central government began to pay out to cover the losses suffered by state enterprises had to pay price subsidies, as well as meet the welfare costs of urban residents and housing programs. Housing came as a particularly heavy burden, as construction material price soared while low rents continued. The price and welfare subsidies in 1988 alone totaled 80 billion yuan, or 30 per cent of the state expenditure.

These fiscal deficits were largely met with domestic and foreign bonds. In 1981 the government resumed issue of domestic bonds, amounting in value to 4.87 billion yuan. As of 1988, 55 billion yuan in domestic bond is still outstanding. Foreign bonds began to be issued in 1980, and in 1988 totalled to U.S.\$41.5 billion outstanding. China thus became the world's fourth largest debtor country, excluding the United States.

The government meets any remaining revenue shortages by borrowing from banks. Bank loans are fairly large. In both 1987 and 1988 the government borrowed 8 billion yuan from these institutions.

The issue of notes and inflow of foreign currency are the major immediate causes of inflation.

Fig. 5. Budget Deficits



Sources: [1, 1989 edition] and Wang Binggan report in *Renmin ribao*, June 26, 1990.

Note: Real deficit ratio = (officially declared deficit + total debt, i.e., government domestic bonds and treasury bill, and foreign debts) / (total revenue - total debt).

C. The Trade Deficit

The Communist Party of China adhered to the principle of balanced trade in the same way as balanced budgeting. However, since 1984 China has been recording continuing trade deficit. The party thus had to renounce its principles of balanced economy. In the six years after 1984, China's deficit exceeded the value of its exports by 30 per cent, although it has been reducing this trade balance through severe import restrictions imposed in early 1990.

These past six years of trade deficit are unusual in the forty-year history of the People's Republic of China, in that the deficit was caused not so much by the import of machinery, equipment, and intermediary products as by the import of high-grade consumer durables. In particular, the huge deficits registered in 1985-86 resulted from the import of expensive passenger cars and high-grade TV sets. As was said earlier, China is experiencing a consumer durables boom. For high-class party leaders, this boom meant a rush to buy high-class foreign

cars and TV sets for conspicuous consumption, to impress the public with their social power and prestige.

The trade deficit must be compensated for by invisible trade gains, but China's earnings in this area are not large enough to cover colossal trade losses.

To meet the trade deficit, China must promote exports and in the short run get more foreign loans. To facilitate both measures, China has repeatedly devaluated its currency. The Chinese currency was depreciated from 1.4962 yuan to the U.S. dollar in 1979 to 3.7221 yuan in August 1986, to 4.72 yuan in December 1989, and further to 5.2090 yuan in November 1990. But the real value of the Chinese currency is still lower, or about 6.2 yuan to the dollar. This latter rate is the rate effective at the forty or so public foreign exchange centers set up in major cities. Only foreign companies having invested in China can exchange money there at this rate. The rate thus reflects the local money supply-demand situations. Even so, the yuan is tending toward further devaluation, because of the basic reality of a consecutive trade imbalance pushing down the yuan's international position.

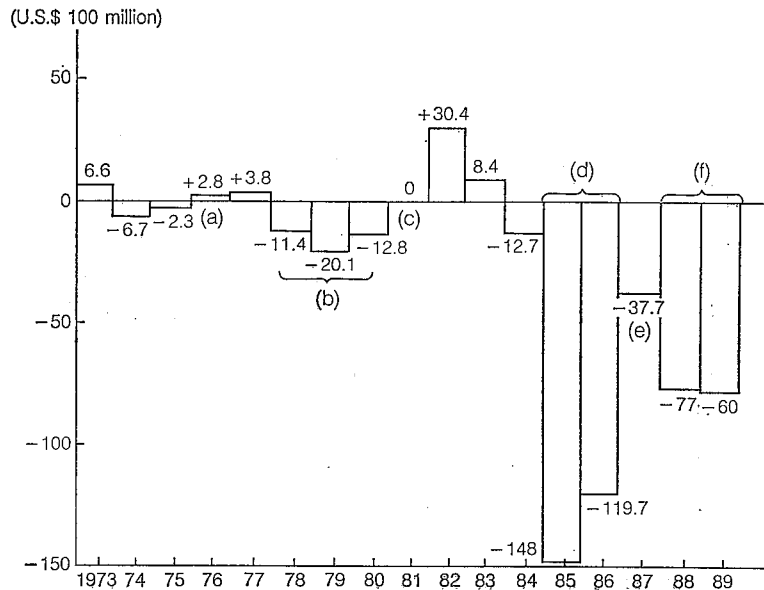
The devaluation of the yuan has caused both the government and the people to lose confidence in their national currency. Not only ordinary people but also enterprises and high government officials are now eager to obtain foreign exchange certificates. The situation since 1985-86 has become even worse since they have now begun to prefer holding actual foreign currency. The Hong Kong dollar is in circulation in the Zhujiang (Pearl River) Delta area, while in Fujian Province across from Taiwan the Taiwan yuan is used openly. Because such a situation has arisen due to a chronic trade imbalance and resultant yuan devaluation, it is bound to last until Chinese exports begin to grow steadily and bring on stable trade gains.

D. *Stagnant Agricultural Production*

The Chinese agricultural sector realized spectacular growth from 1979 through 1984. Grain production for instance made a quantum leap from 300 million tons to 400 million tons during that period, at an annual increase of a surprising 4.7 per cent.

There are four reasons why this was possible. First, there is the heritage of the Mao Zedong period in the form of the agricultural land improvement and irrigation system construction done by people's communes. Secondly, there is the heritage of the Hua Guofeng period in the form of the construction of large chemical plants, resulting in large increases in the supply of chemical fertilizers. As Figure 6 shows, the trade deficit during 1978-80 was caused by the introduction of large industrial plants. These plants included eleven large fertilizer factories. Hua Guofeng was forced to resign as party chairman partly because of this trade deficit. But it should be remembered that the explosive growth in agricultural production was due in great part to those same Hua-imported fertilizer plants. Thirdly, individual farmers became highly motivated to increase production following the dissolution of the people's communes. Fourthly, there is of course the substantial hikes in the government purchase price of farm products, which caused serious fiscal deficits.

Fig. 6. Trade Balance



Sources: For 1973–88, [1, 1989 edition, p. 633]; for 1989, *Remin ribao*, February 21, 1990.

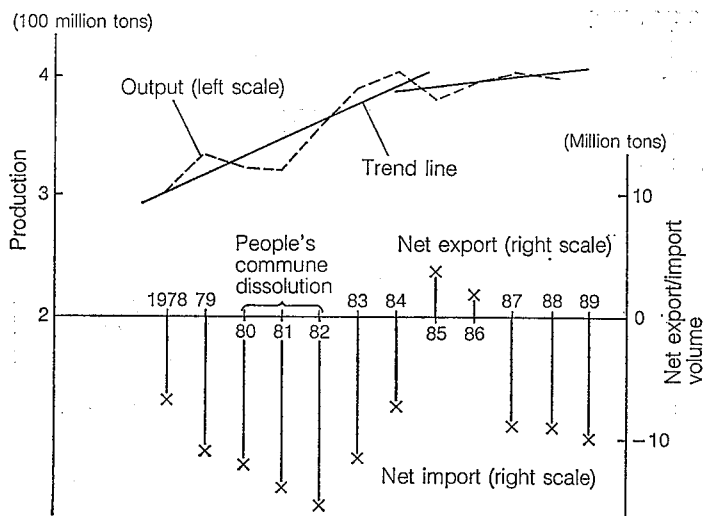
Notes: (a): Tiananmen Square Incident, death of Mao Zedong, arrest of the “gang of four”; (b): Deficit due to capital-goods (industrial plants) import; (c): Hua Guofeng dismissed in June 1981; (d): Import of TVs and cars begins; (e): Resignation of Hu Yaobang in January 1987; (f): Import of parts for TVs and cars begins.

Thanks to bumper harvests for the next five years, China was transformed from a grain-importing to a grain-exporting country (see Figure 7). The compulsory grain delivery system was replaced in 1985 by a contract delivery system, which weakened the government’s control on the peasantry. This success in agricultural policy strengthened the economic reformers’ position, enabling them to overwhelm the conservatives in a series of policy debates.

But agricultural production stagnated in 1985 and continued so for the next five years. China had to import more than 16 million tons of grain annually during 1987–89. China again become nation dependent on grain imports.

There are four reasons why this happened. First, we should point to an ideology and practice of downplaying the importance of agriculture, which dominated the Communist party as well as leaders in the advanced agricultural sector. Around 1985 government investment in agriculture fell to its lowest level. The share that agriculture took from the government coffers in new investments diminished to a meager 5.2 per cent as compared with the previous high of 17.6 per cent during

Fig. 7. Grain Production and Net Grain Imports



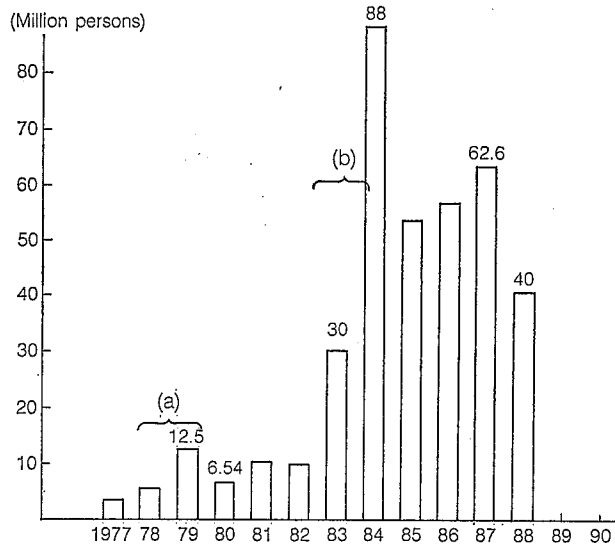
Sources: For 1978–88 [1, 1989 edition]; for 1989, *Kokusai bōeki*, March 13, 1990.

1963–65. On the average, agriculture share had been around 10 per cent. Secondly, following the dissolution of the people's communes, agricultural investment in the form of commune funds and labor through peasant mobilization plummeted. Thirdly, a large number of "individual farms" to whom land utilization rights were granted left their villages as migrant workers, leaving their land fallow. They seemed to regard these land allocations merely as final guarantees of financial security. Finally, agricultural land was increasingly transferred to nonagricultural uses, resulting arable being decreased from 100 million ha in the 1950s to 95 million ha today.⁴

In contrast to stagnant supply aspects, the demand for agricultural products rapidly increased during the 1980s. Demand for meat grew enormously in the cities during the 1970s, and now it is increasing in the countryside. Annual meat consumption per capita nationwide was 8.3 kilograms in 1977, and the figure jumped to 12.8 kilograms for the countryside and 25.3 kilograms for the cities in 1987. This trend toward more meat consumption will probably continue in the future. Thus we see the beginning of a new production cycle in which grain is fed to cattle and then cattle meat is consumed by the people. As a matter of fact, far more grain will be consumed within such a cycle than when grain is directly consumed by the people. Chinese society entered its meat-consuming era in the

⁴ The article by Naoya Wakashiro in this issue gives a full account of stagnating agriculture in China.

Fig. 8. Net Increases in Urban Population



Source: [1, 1989 edition, p. 87].

Notes: (a): Return of rusticated youth. (b): Due to geographical expansion of urban administrative jurisdictions.

1980s, and will need to increase grain production by 10 million tons a year in order to meet the growing demand for meat in accordance with the requirements of a growing population. Unlike Japan, the Republic of Korea, or Taiwan, China with its huge population cannot hope to settle the food crisis by importing grain. Grain production thus will have to be increased by 2.5 per cent every year.

E. *The Urban Population Explosion*

Before 1978, the size of a Chinese city was determined by the amount of food the government was able to supply to its residents. Given the low productivity of agricultural labor, it was difficult to increase the production of commercial crops. Thus, a city could expand only for one year or two until it encounter food supply ceilings. The government would then have had to take stringent economic measures to reduce the number of urban registered citizens. The people's communes used administrative measures to prevent population outflow to cities and thus keep the urban population within the commercial-crop supply limits.

Nevertheless, peasants began a mass migration to the cities for seasonal jobs following the dissolution of 80 per cent of the people's communes at the end of 1982. Figure 8 gives annual urban population increments in China. Determining urban population in China is extremely difficult, since there are conflicting defini-

tions existing about what constitutes urban jurisdiction and urban population. As the urban jurisdictions were significantly enlarged during 1983–84, the urban population came to include large numbers of suburban peasants. During this two years period alone, the urban population totalling about 170 million increased overall by 120 million. It is estimated that two-thirds of the urban-population increase during 1983–84 should be ascribed to the inclusion of suburban peasants by reason of enlarged city jurisdictions. Even so, the addition of 40 million new migrants to the cities in just two years represented a major event in China's rapid urbanization process.

New cities and towns were established and existing urban areas expanded even after 1985, but not on the large scale of 1984. Nevertheless, urban population continued to grow by tens of millions each year. During 1985–88 the urban population just may have increased by as much as 30–40 million per year.

Recognizing that there was no way to reverse this trend, the government in October 1984 officially approved peasant migration to cities smaller than county seats, on the condition that the new migrants not be given access to low priced foods which ordinary urban-registered citizens were entitled to.

Thus, cities now consist of three strata of residents. The first strata consists of long-time residents registered as such. They are given jobs by the government, and once they employed, they are provided with low-rent housing and price subsidies by their employers and given access to cheap food rations, medical services, and pensions. The second strata includes those permitted to migrate to small cities of 100,000 or so population. They are not as amply secure as the first strata, but can expect to obtain similar welfare benefits as their towns or their employers grow economically stronger. The third strata is composed of people, referred to as *mangliu* (blindly floating) people, who have illegally moved into cities and are totally excluded from the welfare system.

The estimated size of the three groups are 200 million, 100 million, and 50 million respectively as of March 1989. Since the degree of government subsidy is fundamentally different from group to group, they form distinct social strata treated differently in terms of their rights as citizens, as well as standards of living. In other words, a very obvious discriminatory structure has been established in urban areas. I have already mentioned the improvement that came about in industrial structure as one of the positive results of economic reform. However, it should be also kept in mind that the resulting industrial structure ushered in a new urban factor, which is highly unsettling both politically and socially.

IV. CONCLUSIONS

What then is the overall evaluation of ten years of economic reform? One cannot help feeling that though the reforms achieved much, the five contradictions stemming from it are so serious that we are forced to reevaluate what was really achieved. The reformers thought, on the other hand, that these contradictions would be overcome by further promoting a market economy. However, the present regime has frozen all new reform plans, arguing that these five contradictions

stemmed directly from too much quick reform. They believe that the problems will be solved by slowing down the pace of reform.

In the short term, I cannot help agreeing with the conservative point of view. However, freezing reform at stage two for three or four more years could generate even more acute contradictions. China today is a mixed economy where strong government control exists side by side with a growing market economy. The general principle at work in this situation is that market economy erodes planned economy. Recall that in 1979 the dual price system for agricultural products effectively dissolved the people's commune. This is the strength of market economy. Therefore administrative schemes can keep market economy already on the move under control only for a very short period of time. If market economy is suppressed for too long, the problems resulting from such suppression is likely to take on a very volatile form, releasing a force that will eventually overturn administrative suppression. The massive return of rusticated youth in 1978-79 represented such a force.

To avoid such eventuality, it seems to me that the policy-makers should be flexible enough to perceive what kind of contradictions are coming to a head between the still powerful administratively controlled economy and the kind of market economy that has been unleashed and give way accordingly to the market mechanism.

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