
FRBSF WEEKLY LETTER

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In a Chinese Village

This is a story of a Chinese village; it is also a story of China's current modernization program. A Buddhist saying goes: "See the universe through a grain of sand." From this simple story of a small, rather insignificant village, one may be able to obtain a glimpse of some important aspects of the vast modernization movement that is sweeping through China today and fundamentally changing the livelihood of one-fourth of mankind.

Hungshan: pre-industrialization

Hungshan is a collective farm of 845 families. It is located on the east coast of China, about 100 miles south of Shanghai, on the south shore of the Chientang River near where the river pours into the sea. Throughout history, the area has been known for a spectacular natural phenomenon: Twice a day, the tide rushes into the mouth of the river in a wall of water dozens of feet tall, foaming and thundering like ten thousand white horses galloping in a line across a battlefield. This sight has made the area a favorite tourist spot, but not Hungshan itself.

Sixteen years ago, Hungshan was a mere salt marsh, with a few households eking out a living by drying seawater for salt. In 1969, a dramatic change took place. During the height of the Cultural Revolution (1966-1976), a decree was issued to turn the marsh into arable land for growing food grains. In the spirit of those daring times, the decree was carried out with no consideration of the costs involved. Hordes of laborers were mobilized to build dikes, dig drainage trenches, plant legumes that thrive on salt (thus removing salt from the soil), and construct irrigation canals. Three years' hard work achieved the decree's objective: the salt marsh was turned into high-yielding rice fields. It was supposed to be another triumph of the Cultural Revolution.

Yet, despite the gigantic and successful fight against nature, it is doubtful that the effort paid off in an economic sense. Out of the huge investment in labor and capital arose the newly established Hungshan Collective Farm of a few hundred desperately poor households eking out a living by growing rice. One reason for their poverty was that

the government set farm product prices so low relative to industrial prices that farm income barely reached a subsistence level. The price system in effect taxed farmers to keep down the cost of urban living. Another reason was that farm production was carried out by work brigades. Workers were paid by the hours put in, with no regard to productivity or individual initiative. The net result was that the rural standard of living remained far below that of the urban, and a nationwide household registration system kept rural populations from migrating into the cities.

Industrial take-off

In 1978, the new national leadership launched the Modernization drive designed to breathe new life into the national economy by dismantling the rigid Soviet-type economic structure that was erected twenty-five years earlier. Under the new policy, market incentives were to replace ideological fervor as the motive force for economic activities. Bureaucratic controls over the economy were to be loosened to give private enterprises more latitude in making decisions. Individuals were to be rewarded for their productivity and initiative. A market mechanism was to be activated to help allocate resources in a fundamentally socialist economic system. Furthermore, transformation was to be gradual, experimental, and to start from rural areas where eighty percent of the population resided.

The new wind reached Hungshan in 1980. A new team of village leaders decided that the time had come for the village to pull itself out of poverty through industrialization. Seeing the widespread shortage of building materials, they hit upon the idea of building a cement factory. A group was sent to procure technical advice from cement plants elsewhere. The collective's meager surplus fund was used as initial capital, plus a small capital loan from a government bank at zero interest. In addition, advance payments were asked of customers, who were eager to comply in order to ensure future delivery of much needed cement. The factory started operation in 1980, and was a spectacular financial success by the very next year.

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Emboldened, the farm plowed profits into starting a ceramic tile factory, a slate-polishing factory, a cloth-dyeing factory, a clothes-making factory, a plastic-molding factory, a television shell factory, and a farm-machinery parts factory in the succeeding years. By late 1984, a total of 18 enterprises had been established.

In the short span of four years, the structure of the village's economic activities changed drastically. The collective farm was replaced by the Hungshan Agricultural-Industrial-Commercial Development Corporation, which serves as the holding company for the 18 separate enterprises. As the corporation's name implies, its businesses encompass three areas of economic activity. Whereas in 1978 the collective farm depended mostly on farming, five years later the corporation generated 84 percent of its 1983 revenue from industry, 6 percent from commerce, and only 10 percent from agriculture. During the same period, agricultural employment fell from 80 percent of total employment to 37 percent, and industrial employment rose from 16 percent to 58 percent, while commerce and education's combined share rose from 4 to 5 percent.

With a more diversified industrial structure came the problem of securing future supplies of energy and raw materials. Given the inadequate distribution system and the distorted price structure in China, ensuring a steady supply of energy was the first requirement for sustained industrial growth. The village corporation's managers contracted to make a substantial capital investment in a small coal mine in a distant province to ensure an adequate supply of coal for the village in future years. But at times, capital alone was not enough. In one case, the corporation had to agree to help train plastic-molding technicians in another province to get the provincial authorities to supply coal to the village.

The corporation has further diversified its portfolio by, for example, investing in a large beer brewery nearby. In 1984, plans were afoot to build an eighteen-story commercial building and an air-conditioned movie theater in the county city.

Industrialization raised the village's income at a dizzying rate. From 1978 to 1983, its total net income increased 470 percent from 1.6 million yuan to 8.9 million yuan. After deducting for tax payments and the corporation's surplus funds, per capita distribution in 1983 was 860 yuan in 1983 — triple the amount of 285 yuan in 1978.

Welfare

With the higher income came improved living conditions. I was taken to see one of the eight housing developments in the extended village. These were handsome two-story pre-fabricated concrete houses, decorated extensively with locally produced ceramic tiles and polished slate, containing spacious and airy rooms and traditional farm-kitchen facilities (that used dried rice stalks for fuel). They were called "third generation" houses. The corporation manager proudly contrasted them with the "first generation" and "second generation" houses in the distance to show the progress that had been made in the last five years.

Inside, the houses were remarkably clean and well-furnished — suspiciously looking like model homes in U.S. new housing developments. The host proudly showed the visitors the new television sets, refrigerators and bicycles. Across the backyard from one main house was a low structure used for raising dozens of chickens, with light bulbs to keep them warm. The visitors were told that there were fish ponds as well as fruit orchards nearby to supply the villagers' needs.

In addition, the village has also built a four-story school building. Education from kindergarten through junior high school was free. The village did not have a high school. It provided scholarships of 300 yuan per year for students who were accepted into high schools elsewhere, and 1,500 yuan per year for those who entered universities. The village also paid for 70 percent of medical expenses up to 30 yuan per illness, and 100 percent above that amount. For families of a single child, it paid 30 yuan per year up to 14 years. The village claimed not to have had a new family with more than one child in the past six years.

Incentive vs. equity

A great deal of credit for the village's spectacular economic success was given to entrepreneurship, and entrepreneurship was richly rewarded. In 1983, the cement factory was contracted out to a five-man management team with a target profit of 1.6 million yuan — twice the amount that was realized in 1982. Under the contract, each worker was paid a flat wage rate of 34.5 yuan per month plus a floating bonus depending on the amount by which the factory's target profit was exceeded. That year, the factory netted 2.13 million yuan in profit. As a result, the workers averaged 3,000 yuan income per person, and the five-man management team each received more than 10,000 yuan.

The clothing factory suffered losses in 1982. In 1983, the factory switched to the new incentive system. It was contracted out to a young man from a neighboring village who had had six years of clothing-sales experience. Through innovative management methods and introduction of new products (new-style shirts and ski jackets), the factory realized a 250,000 yuan profit in 1983. The manager received a total of 29,000 yuan that year, including bonus, and became the highest paid person in the village. In a country where per capita income was about 400 yuan a year, these remunerations were indeed astronomical.

Newspapers have reported these income disparities with approval and relish. These cases were cited as successes of the new incentive system. It is the government's proclaimed policy to permit a few people to get rich first in order to help everybody else get rich later.

Assessment

This story of Hungshan Village is based on data collected during a half-day visit to the village, supplemented by information contained in newspaper reports. The two sets of data are so similar that they clearly came from the same source. The dependability of that source cannot be verified. Moreover, the village was apparently displayed to visitors as a "showcase" for the new government policy's success. A cautious visitor must be wary of the information's usefulness and significance in the vast and complex country that is China.

However, there is other evidence to suggest that Hungshan's story is not an officially fabricated fantasy. Western journalists have reported similar explosions in rural industrial growth in other parts of the country. In particular, one in-depth analysis of China's economic growth by region (conducted in 1984) points to the "important role played by collective enterprises, and rural industry in particular" as a striking feature of the fastest growing provinces: Jiangsu and Zhejiang on China's east coast. Jiangsu is reported to have 68,000 rural enterprises, employing 4.35 million workers in 1984. Since 1978, the average annual output growth of these rural enterprises was nearly 25

percent, compared to 9 percent for state enterprises in that province. In Zhejiang, which contains Hungshan Village, some 40,000 new township-run enterprises were established in 1984 alone. The Beijing Municipality, which includes Beijing (the nation's capital) and 10 surrounding counties, had 16,500 rural enterprises in 1984, up from 8,900 in 1983. On the basis of this evidence, it appears that Hungshan's story not only is not a myth, it also is not an isolated phenomenon.

More significantly, Hungshan is a concrete manifestation of what the Modernization policy intends to achieve. Perhaps, the earlier reference to a "model home" is, after all, rather appropriate in the present context. Hungshan Village and its story symbolize the ideals the nation's new leaders are striving to attain. In a fundamental sense, these ideals are perhaps not that different from those that had prevailed for thirty years before the new leaders came into power. However, in terms of the means for achieving the goals, the departures from the old path have been significant.

From this viewpoint, the story is noteworthy because it helps highlight a few interesting points about China's Modernization drive. First, it demonstrates that by giving free rein to industrial development outside the rigidly controlled state-enterprise sector, a vast reservoir of entrepreneurship and creative energy can be released to propel the country's economic growth. Second, the deliberate allowance of income disparity has provided a large incentive for individual initiative that was absent in the old regime.

Third, rural industrial development has continued to be distinctly socialistic: the enterprises were collectively owned by village or township corporations and not by private individuals. Fourth, by encouraging rural industrial development — and thereby providing jobs where the majority of the population resides — China may be able to mitigate the ills of urban concentration that have plagued many developing nations.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding	Change from	Change from 10/10/84	
	10/9/85	10/2/85	Dollar	Percent ⁷
Loans, Leases and Investments ^{1 2}	195,142	- 970	11,496	6.2
Loans and Leases ^{1 6}	176,079	- 809	10,996	6.6
Commercial and Industrial	51,033	- 454	557	1.1
Real estate	65,164	104	3,847	6.2
Loans to Individuals	35,923	- 13	5,654	18.6
Leases	5,405	0	370	7.3
U.S. Treasury and Agency Securities ²	11,823	- 160	182	1.5
Other Securities ²	7,239	- 2	318	4.5
Total Deposits	199,640	- 2,822	6,629	3.4
Demand Deposits	47,206	- 3,044	461	0.9
Demand Deposits Adjusted ³	32,792	- 53	2,439	8.0
Other Transaction Balances ⁴	14,220	116	1,665	13.2
Total Non-Transaction Balances ⁶	138,214	106	4,502	3.3
Money Market Deposit Accounts—Total	45,302	94	7,340	19.3
Time Deposits in Amounts of \$100,000 or more	38,570	13	- 2,907	- 7.0
Other Liabilities for Borrowed Money ⁵	22,546	894	2,713	13.6
Two Week Averages of Daily Figures	Period ended 10/7/85	Period ended 9/23/85		
Reserve Position, All Reporting Banks				
Excess Reserves (+)/Deficiency (-)	- 62	61		
Borrowings	82	39		
Net free reserves (+)/Net borrowed(-)	- 144	23		

¹ Includes loss reserves, unearned income, excludes interbank loans

² Excludes trading account securities

³ Excludes U.S. government and depository institution deposits and cash items

⁴ ATS, NOW, Super NOW and savings accounts with telephone transfers

⁵ Includes borrowing via FRB, TT&L notes, Fed Funds, RPs and other sources

⁶ Includes items not shown separately

⁷ Annualized percent change