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Economic Reform in China  
Some Impressions\*

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ECONOMIC REFORM IN CHINA - SOME IMPRESSIONS

Since 1978, the leaders of the People's Republic of China have embarked on a programme of reform whose avowed objective is a fundamental restructuring of the economic system. The dismantling of the commune system, the assiduous wooing of foreign technology and capital, the retreat from egalitarianism, and the emphasis on material incentives and free play of market forces imply a rejection of many of the basic tenets of the earlier period.

It has also called into question the very features for which China was widely admired not so long ago - its apparent success in providing everyone a minimum of food, clothing, education and health care; infusing a high degree of social concern in individual behaviour; mobilising idle manpower on a massive scale for investment; striking a judicious balance between traditional and modern techniques in its pursuit of modernisation and achieving a high rate of overall growth on a self-reliant basis.

In this article the author gives some of his personal impressions gathered during a recent month-long visit to China as part of a team of economists sponsored by the Indian Council of Social Science Research. The visit, hosted by the Chinese Academy of Social Sciences, gave an opportunity to see the working of the reform in farms and factories in and around four major cities (Beijing, Shanghai, Chongqing and Guangzhou) and also to discuss it with social scientists in research institutes.

The reform started with a thoroughgoing change in the commune system which was, for nearly two decades, the basic framework of economic and political organisation in rural China.

The system was built on the principle of collective ownership and use of all productive resources and sought to combine egalitarianism in distribution with self-reliant local development under the leadership of the cadre of the Chinese Communist Party. This made for integration of political and economic management at the local level and for effective central control over the rural economy.

Although the progress in production and resource mobilisation under this arrangement was significant, its defects became a focal point of the struggle in the early Seventies. The culmination came in the 11th Party Congress which decided to delink the economic from the administrative functions of communes and switch from collective production and distribution to a reliance on individual enterprise and material incentives.

The centrepiece of the new arrangement, which the Chinese call 'the responsibility system', is the cultivation of land by peasants individually, or in groups, under contract with their team. The form of the contract varies.

Thus in one commune in suburban Beijing we visited, the collective decides when, where and how much land is to be sown to different crops, takes care of land preparation, sowing and harvesting, and also provides all inputs other than labour. After planting, the area is contracted to individual peasants at the rate of 15-20 MU (15 MU = 1 hectare) per labourer. The peasant's responsibility is to tend the crop and carry out all the operations up to the harvest for a payment linked to the size of the harvest on his allotment. Since the size of the harvest directly affects the income of the peasant - so the argument goes - there is a built-in incentive for him to take proper care of crops on his contract land.



A similar system is reported in vegetable farms in the Shanghai area also. But the more common practice there seems to be for the team to distribute land among members on a long-term contract (10-15 years), with each member responsible for carrying out all the cultivation operations on his contract land. However, the contract specifies each year the extent of area to be sown to different crops and in different seasons, the expected yield and the amount to be delivered to the State. The contracting farmers usually hire machinery from the collective - most animals and farm machinery in this area are owned by the teams or the brigades - and buy the other inputs from outlets run by the collective.

#### FLEXIBILITY

Each farmer has to deliver the designated quantities of different grains to the State at fixed prices. In addition, he has to pay a specified amount toward land tax and as contribution to the collective fund. Any excess which remains after meeting these obligations, can be sold to the State at a premium (as much as 50 per cent of the price given for compulsory quota); or - and this is said to be increasingly the case - he can sell in the free market.

In Chongqing and Guangdong, the contracting farmers seem to have even greater flexibility. The contract merely specifies the tax and delivery quotas which the peasant has to fulfil. As a proportion of output, these obligations are also much smaller than in Shanghai and Beijing. And farmers are allowed to own and acquire animals, farm machines and irrigation equipment. In Guangdong, all collectively-owned animals and machines are reported to have been sold to individual peasants when the contract system was introduced. In some areas, at any rate, the dilution of collective ownership of the means of production has gone quite far.

The basis for division of the produce and the determinants of the individual peasant's income under the new system are quite different from the earlier arrangement. Prior to 1978, when production was wholly collective, the team decided on the distribution of product (net of inputs and taxes) among its members. Part of the produce was used for collective consumption, including the provision of a minimum amount of food for those who could not work for reasons of health or age. The rest was distributed among members in accordance with the workpoints they had accumulated over the year.

In principle, the system was supposed to differentiate the nature, volume and quality of work done by individuals. But in practice there were numerous problems which made for dissatisfaction. The relation between the effort of an individual worker in cultivation and his income was further weakened by the fact that workpoints for tasks other than cultivation - and, in particular, for work done in capital construction which was not always of direct benefit to the team - were also taken into account in the distribution. This, together with the tight State control over the crops to be grown by each team, the inputs it used, and the prices of inputs and outputs is now seen to have greatly hampered the growth of production.

#### CHANGES

The new system seeks to bring the incomes of individuals in much closer and direct relation to the work they do in particular activities and their productivity. Contract cultivation on an individual basis is one important aspect of this. Peasant contributions to collective welfare funds have been reduced; work on activities other than cultivation is organised and paid for separately. Peasants now have greater flexibility in deciding what to grow and how to dispose of the products of both contract land and private 'sidelines'.

The area under private plots has increased and is now around 15 per cent of the cultivated land; farmers are free to decide how much labour and other resources they devote to their private plots and animals and they can sell the produce in the free market. In addition, prices of farm products have been raised substantially; prices payable for compulsory grain deliveries were raised by 20 per cent in 1979, with a premium of 50 per cent for deliveries in excess of quota.

All of this is said to have acted as a powerful stimulus to growth and diversification of agricultural production. Official statistics point to a near doubling of the growth rate in gross agricultural output in the last five years compared with the previous 25 years. The increase in growth rate of crops other than foodgrains and of animal husbandry is particularly striking. The output of animal husbandry has more than doubled in the last five years.

An average annual increase of 7.5 per cent in agricultural production in a country of China's size and one which has already reached high levels of productivity is so exceptional that the first impulse is to ask whether the data are reliable. The possibility that the statistics of different periods may not be equally reliable or comparable is, however, discounted by Chinese experts.

#### DIVERSIFICATION

The liberalisation of policy on starting and expanding collective nonagricultural enterprises, which came alongside the agrarian reform, seems to have further diversified the rural economy. In China as a whole, commune and brigade-level enterprises are now estimated to contribute a little

over a third of the total gross production of rural collectives compared with about a fourth in 1978.

Industrial enterprises alone currently contribute a little over a fifth of the total output of the commune sector. The importance of industry in the communes we visited is considerably greater than this (accounting for between one third and one half of the employment and upwards of half the gross production value) and, given their proximity to the large and growing markets of the big cities, has probably grown rather faster than average.

The range of products manufactured by the rural collectives is very wide and includes agro-processing, cement, bricks and other construction material, furniture, garments, light engineering goods. Most of them are organised in medium and small units but some are large modern factories. One commune factory in suburban Shanghai, employing 1,500 workers, produces nearly one-tenth of the total electric bulb output of China!

#### MODIFICATIONS

The rapid expansion of non-agricultural activities has given rise in some cases to labour shortages in agriculture and to modifications in the contract system. The existence of sizable income differentials between agricultural and non-agricultural work within the same commune was mentioned as an important problem in all the communities we visited. A variety of devices are used to meet this: mutual sharing of labour in peak seasons; greater involvement of women and older people in cultivation with adult males and children lending a helping hand in their sparetime; and allowing anyone who cannot or does not wish to cultivate his contract land to hand it over to someone else who wants to.

Some communes set apart a portion of the profits of the brigade and commune enterprises to support mechanisation of agricultural operations, contribute to collective welfare and accumulation funds to ease the burden on peasants, and even give direct income supplements to peasants. One commune near Changqing reported that non-agricultural enterprises give as much as 200 yuan per annum per cultivator in one or other of these forms.

The phenomenon of sub-contracting, found both in Shanghai and in Guangdong, involves a reallocation of cultivated land among the members of a team. To begin with, the collective land was divided equally among the members (either on a per capita or per worker basis) and given over to individuals on a long-term contract. Sub-contracting necessarily alters this distribution, and leads to greater variation in the size of cultivation holdings within each team. The peculiar feature of this sub-contracting is that since land belongs to the team, the peasant who transfers land cannot charge any rent. A person who cultivates land under this arrangement is expected to meet the tax and the compulsory quota obligations pertaining to that land. Sometimes he agrees to supply, at prices fixed by the State, the foodgrain needs of the household which gives the land. This is to the latter's benefit since the only alternative is to buy grain in the free market at much higher prices; commune members not being eligible to State rations.

But in parts of Guangdong province, there are instances where the household gives out its contracted land to others without getting anything in return; and in the Pearl river delta, there are cases of such households paying 100 to 200 yuan per MU (a fifteenth of an hectare) to the person who cultivates the land. The extent of such contracting

arrangements appears to be as yet relatively small - one Guangdong commune reported less than 5 per cent of land to be under all forms of sub-contracting - but that individuals should pay others to cultivate land is puzzling.

#### INCOMES UP

Altogether the reforms are reported to have resulted in a significant increase in per capita incomes of peasant households. According to official statistics, the average for all China has more than doubled in the past five years, from 134 yuan in 1978 to 330 yuan in 1983. The system of individual cultivation and the rapid increase in the importance of private sidelines almost certainly increased income disparities within teams and to the extent that communes closer to urban areas which are more affluent to begin with may have gained more from the reform, the disparities between teams as well. (inter-team disparities are quite large: according to a survey in the early Eighties, about one-eighth of the teams had a per capita income 40 per cent or less than the national average while about a sixth had one and a half times or more than the average.) The progressive reduction in the share of collective accumulation and welfare funds as a proportion of farm income and even more as a proportion of total income, would also work in the same direction. While little is known about the net impact on the income distribution in rural China, a widening of disparities is now seen to be a desirable and necessary spur to larger and more efficient production.

The restructuring of the rural economy, though drastic, has been accomplished remarkably smoothly. All peasants stood to benefit from the higher prices and the greater freedom over production and marketing, though in varying degrees. It is not surprising therefore that the reform should be so widely welcomed in rural China. The potential opposition from urban areas, which would have been adversely affected by the higher

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price for farm produce, was neutralised by giving a liberal subsidy (which at present accounts for 15 per cent of worker's earnings) to compensate for this likelihood. The picture in the case of industry is rather different.

China's industrial development over the past three-and-a-half decades has been very impressive in overall terms. But over the past seven years, there has been a sharp awareness of the weaknesses of the industrial system. In October 1984, the Communist Party of China adopted a major policy document for restructuring industry. What is the thinking behind the new strategy? What are the essential components of the reform? The author, an Indian economist who recently spent a month in China offers his impressions. In the last issue, he dealt with the big change in China's rural economy.

In October 1984, the Central Committee of the Chinese Communist Party adopted a document entitled 'Decision on Reform of the Economic Structure'. It is in the nature of a blueprint for major changes both in the strategy of industrial development and in the system of planning, management and regulation of industries.

Since the Revolution, China, like India, has pursued a strategy of rapid expansion and diversification of the industrial base, with a strong emphasis on building heavy industries. All available statistics suggest that the Chinese have been remarkably successful in achieving this goal. According to official estimates, the gross value of industrial production has been rising at the rate of 10-11 per cent per annum during the last 3 decades, which is nearly twice the rate recorded by India.

In the early Fifties China's industrial base, like that of India, was very narrow. Indeed in several key sectors, its production was about the same, or lower, than India's. Since then, China has achieved much faster growth in practically every major branch of industry and more so in industrial raw materials, semi-finished goods and capital equipment.



Currently China's production of crude oil, coal, metals, cement, fertilizers, refined petroleum and machinery far surpasses India's and ranks among the top 5 or 6 in the world. That this was done largely on the strength of indigenous effort - the only significant foreign aid came from the Soviet Union but was withdrawn abruptly in 1959 - makes the achievement all the more impressive.

However, in the last few years, the Chinese Government has been far more concerned about the weaknesses of the industrial system. Recent publications by several leading Chinese scholars highlight bottlenecks in energy and transport; long and increasing delays in completing projects; unused capacity in several branches of industry (steel and machine tools are often mentioned as examples); low quality of products; excessive emphasis on meeting quantitative targets without regard to the saleability of products; outmoded techniques and technological stagnation; and inadequacies in the distribution system. (An Indian cannot escape noting a familiar ring in these criticisms.) These weaknesses, and the resulting inefficiencies, are being attributed to basic defects in the way industries have been planned, organised and managed.

Industrial enterprises in China are owned by the State or by the collectives: State enterprises, of which there are currently some 84,000, dominate the scene, accounting for over threefourths of the gross industrial production. Collective enterprises include 1,10,000 units owned and operated by workers' collectives in urban areas. Commune-owned enterprises, although more numerous (1,85,000 units), are not significant in terms of output and employment. There is no private industrial enterprise worth mention.

Until recently, the Government departments at the Centre and in the provinces had a tight control over the establishment and operation of all these enterprises. Investment decisions were highly centralised - with the departments deciding which of the existing plants were to be expanded or modernised, where and on what scale new projects were to be set up, what processes were to be used and what was to be produced. The operation of the plants was subject to detailed guidelines and instructions from the departments which appointed the key personnel, specified in detail the production targets and the sources from which materials were to be obtained, fixed the price of raw materials, labour and products, and provided the capital.

All manufactures were to be distributed through State trading agencies. Any surplus the enterprises may earn had to be turned over to the State. The individual enterprise had thus little room for manoeuvre and frequently had to cope with conflicting instructions from different agencies. It is further suggested that the emphasis on vertical leadership had led to different departments and regions building 'integrated' production systems without regard to efficiency and leading to "endless wrangles" between them.

A series of reforms aimed at correcting these deficiencies was initiated in 1978. After five years of experimentation in selected enterprises and regions the party's October 1984 document detailed a comprehensive general policy for restructuring industry. Based on this document, discussions with researchers at the national and provincial academies of social sciences, and visits to some 8-10 industrial establishments (including an integrated steel plant, large factories making watches, bulbs and toys, and several small collectively-owned factories producing leather, shoes, building materials and garments), we got a broad picture of the main features of the ongoing reform and its effects.

The reform has the following essential components, namely, changing the investment priorities; opening the door to latest technology from abroad; introducing a responsibility system at the enterprise level; and a drastic restructuring of organisation and management of the industrial system as a whole.

Changes in development priorities, set in motion quite early during the reform, consist essentially in (a) allocating more resources to remove the bottlenecks in the production and distribution of energy and in transportation facilities; (b) reducing the share of heavy industry in new investments and increasing allocations to consumer goods industries and housing; (c) stressing the modernisation and improvement of existing facilities (especially in heavy industry) rather than construction of new plants and (d) giving greater attention to improvement in the range and quality of goods produced in accordance with demand rather than to mere quantitative expansion

Official statistics do show a significant change in investment allocation. The share of light industry in total industrial investment has increased from 11-12 per cent in the early Seventies to over 20 per cent currently. Investment in residential construction has risen dramatically and currently accounts for over a quarter of all investment compared to less than 8 per cent in 1978. Output of light industry which till the mid-Seventies grew at a slower rate than that of heavy industry is reported to be growing much faster - 70 per cent, between 1978 and 1983 against 28 per cent in heavy industry.

#### CHANGING ATTITUDE

China's attitude to foreign economic relations has changed radically. The earlier policy of near-total self-reliance is now blamed for denying Chinese industry the benefits of rapid technological progress in the developed world and keeping it backward and inefficient.

As the 12th congress of the Communist Party of China put it: "The productive forces including science and technology in our times are developing ever faster. Although international relations are complex and ridden with contradictions, international economic and technological ties are ... very close and national seclusion cannot lead to modernisation. Since the third plenary session of the eleventh Central Committee, we have taken opening to the outside world to be our long-term basic policy, a strategic measure for accelerating socialist modernisation." The new open-door policy extends to trade, capital and knowhow. The creation of special economic zones and the vigorous efforts to import foreign technology are its concrete expressions.

The special economic zones, of which there are five at present (14 more are being set up), are enclaves where foreign investors are offered special facilities, including freedom to get imported materials, equipment and personnel, and freedom from taxation, to produce for export markets. Of late, the Government has indicated its willingness to allow enterprises in these zones to sell a part of their output in the domestic market.

Far more important is the intensive and many-sided effort to attract foreign technology and capital to upgrade domestic industry. There is a sustained campaign through innumerable conferences, seminars and delegations to make foreign investors aware of the opportunities for profitable investment in China and the various concessions and guarantees which the Government is willing to offer to protect the interests of such investors. The Chinese have also adopted, as will be evident from the following examples, a highly flexible attitude to forms and terms under which foreign capital and knowhow will be entertained.

At one extreme is the Shoudu Iron and Steel works near Beijing which has recently modernised its plant by importing up-to-date equipment (in this case computerised process control) directly without involving any foreign collaboration or investment. In Changqing, we visited a motorcycle plant which produces the vehicles in technical collaboration with Honda. The motorcycles are based on the imported design and specifications, and the Japanese are reported to have assisted in setting up the plant. The product is marketed in the joint name of the company and Honda, for which the Japanese firm gets a royalty on sales.

#### MODEST RESULTS

The Baoshan steel plant under construction near Shanghai is an instance where the plant itself is owned and financed by the Chinese Government, but the design, fabrication and installation of furnaces, rolling mills and other key sections of the plant have been wholly contracted out to foreign companies. Then there are the joint ventures in which the foreigners provide both capital and knowhow. Depending on the circumstances, the Chinese are now prepared to consider a wide range of terms not excluding complete foreign ownership and control. The results of these initiatives so far seem rather modest.

Thus Shenzhen, the largest of the existing zones, employs only about 1,30,000 workers and has approximately 400 enterprises, mainly agro-processing and light manufactures, almost all of which have been set up by overseas Chinese. Barely 200 foreign collaboration agreements (many of which are in light manufacturing) involving a total investment of less than \$2 billions are reported to have been concluded so far. The agreements for import of technology are several times larger in number, but not in terms of investment. Details of the nature and magnitude of these agreements and the

contribution of different countries are hard to come by, but evidently the pace of foreign inflow is quickening. The Chinese themselves see this as a beginning and are both eager and hopeful that the flow of sophisticated technology and capital will grow to significant dimensions in the future.

The October 1984 document contains but a general statement on the necessity to import technology without specifying exactly how it will be absorbed, adapted and improved indigenously. The following statement by Prof. Ma Hong, a major figure in shaping the current reform, is suggestive:

"Technology and equipment which are crucial to China's modernisation should be imported from abroad as well as materials which cannot be produced within the country either due to shortage of needed resources or because of a lack of advantageous economic conditions. Imports of complete sets of equipment should be strictly controlled. We must strengthen our ability to re-produce imported equipment and to manufacture new types of equipment as needed. Certain types of equipment which could be manufactured domestically or which can be made only if some additional technology were imported, should not be imported. Furthermore all duplication in imports must be eliminated".

#### GREATER AUTONOMY

Internally, the restructuring programme aims at correcting the excessive centralisation of planning and implementation. As in agriculture, greater autonomy and responsibility to individual enterprises is a central feature of reform in the industrial sector. During the last five years, a series of changes has been introduced as a result of which enterprises are free to produce more than their prescribed quota and dispose of the excess on their own, at prices higher than that fixed by the State. Materials and products which are not

bought by the State departments can be sold by the enterprises directly. Profits in excess of the specified quota to be delivered to the State, can be retained by the enterprises and used partly for payment of bonus to workers.

Enterprises are also allowed to take up on their own projects below a specified level of investment. And within the framework of the basic wage structure fixed by the State, individual enterprises are allowed and encouraged to devise ways of linking actual earnings (including bonus) of an individual worker to his or her performance.

The State's interference in the appointment and control of personnel has also been reduced. The collectives appoint their own managers, and have the right to fire them without reference to the party or the State. Though managers of State enterprises are appointed by the State, suggestions from workers are entertained.

#### WIDESPREAD CHANGES

Changes at the enterprise level seem to have graduated from the experimental stage and become quite widespread. Individual enterprises, especially in light industry, are reported to have much greater freedom in deciding their production; freedom to produce above the quota as well as the right to retain part of the profits and decide on its disposition subject to certain broad guidelines now seems general. The earlier practice of specifying the amount of profits which each enterprise should hand over to the State has been replaced by a system of profit taxation. While there is no change in the basic wage rate structure, bonus linked to work performance is common and the piece rate is becoming more important. Thus in 1982, 11 per cent of workers' earnings consisted of

bonus (compared with 2.3 per cent in 1978) and some 8 per cent of wages was paid on piece rates (against less than 1 per cent five years earlier). This seems to be a continuing trend, although figures for the latest years are not published yet.

Greater freedom to enterprises necessitates substantial changes in the system of planning and regulation as a whole. The restructured system as outlined in the October 1984 document visualises a drastic reduction in the scope of mandatory planning (that is, planning and implementation on the basis of detailed targets set by the Central planners and supervised by the departments).

For the rest, and it is hoped the larger part, of the economy, the State will limit itself to setting indicative targets and use indirect instruments - price, taxes, subsidies and credit - to influence enterprises in desired directions. In some cases, enterprises may even be left altogether free to be guided by the market.

One consequence of this is a vastly more important role for prices in guiding resource allocations. A major concern is to correct the irrationalities in the existing system in which "prices of many commodities reflect neither their value nor the relation between supply and demand". Changes in view include a reduction in the scope of the administered prices and a corresponding enlargement in the role of the market forces and correction of certain major distortions in the structure of administered prices.

Under the restructured system, the role of the socialist government would be limited to formulating overall strategy, plans, principles and policies for socio-economic development; coordination between departments and regions; exploitation of



natural resources; and the development of technology. Direct responsibility for construction will be limited to projects in such key areas as energy, transport, and raw and semi-finished products. The functions of departments inter se and in relation to enterprises are being redefined to restrict the scope for government interference in management and to "break down the barriers between departments and regions". Planning is to be on a regional and not a departmental basis.

## TRIALS

Several elements of the proposed restructuring of the planning and regulatory system have been tried out in selected regions and enterprises. These include efforts to reorganise industrial enterprises through amalgamation, integration and encouragement of specialisation to make them viable and efficient units; rationalisation and simplification of the government departments concerned with industrial development in selected countries; evolving new institutional mechanisms for regional planning of industry; allowing greater autonomy to local governments in selected major industrial centres to reorganise and modernise existing industry and plan their future growth; and experiments with reform of the price system. During our visit we could get a feel of these experiments in particular provinces like the reorganisation of industrial enterprises in Shanghai; the Changqing experiment at integrated planning of regional development with a major industrial centre on the node and the attempt in Guangdong province to devise a more rational price system.

The picture obtained, sketchy as it is, suggests that a well defined and unified approach to these questions is still some distance away. The party blueprint lays down only the general directions, emphasising the need to work out solutions adapted to local conditions by a process of trial, error and adaptation.

This part of the reform is obviously the most complex and difficult. Its various strands, being inter-related, cannot be planned or implemented piecemeal. Thus the relaxation of restrictions on industrial enterprises of collectives and local governments in 1978 led to a surge of investment but in the process the finances of the government came under severe strain and it is reported, resulted in much wasteful duplication and excess capacity in several branches of industry. Also unlike in the case of communes, power in relation to industry is much more centralised in the bureaucracy.

The potential disturbance in the existing pattern of relations between enterprises and departments, and between the different levels of government, as a result of the proposed reform is therefore likely to be much greater. Moreover, the impact of the reform on different enterprises and regions will be far from uniform. Firms which are making losses face the prospect of retrenchment or closure when the subsidies are curtailed or withdrawn. A general rise in price of raw-materials and semi-finished products relative to finished goods could increase the profits of the former industries at the expense of the latter and of raw material producing regions at the expense of those specialising in finished goods manufacture. Alternatively it could lead to cost inflation. Attempts to promote free trade in manufactures between regions may also face resistance from the backward regions.

It is perhaps in recognition of these problems and hazards that the October document emphasises the "exploratory and innovative character of the reform", the necessity to implement unified solutions suited to specific situations in a planned way, the importance of learning from experience, the need to absorb increased prices of raw materials by using them more economically and the advice of "extreme prudence"

in carrying out the price reforms. Nevertheless, the party leaders seem confident that these are manageable problems and that appropriate solutions can be found and implemented in an orderly and yet speedy manner. The actual course of the reform and its effects merit watching closely especially in India.