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On the Reform of Rural Supply and Marketing Cooperatives in China

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(Accepted 5 October 1987)

Abstract

Wan, G.H., Zhou, Z.Y. and Dillon, J.L., 1988. On the reform of Rural Supply and Marketing Cooperatives in China. *Agric. Econ.*, 2: 73–88.

As a bridge between city and countryside, industry and agriculture, producer and consumer, Rural Supply and Marketing Cooperatives (RSMCs) play a key role in distributing commodities and purchasing rural products for some 800 million people in China. While overall national economic reform started in 1978, the reform of RSMCs began 4 years later in 1982 with greater emphasis on recovery rather than reform. This paper reviews the development of RSMCs, describes their operation and appraises the reform underway since 1982. It concludes with some policy suggestions relative to further reform of the RSMC system.

Introduction

In China, there are currently some 2100 county-level Rural Supply and Marketing Cooperatives (RSMCs), 35 000 commune-level RSMCs and 670 000 local-level RSMC shops. With a workforce of 4.3 million and fixed assets valued at ¥29 000 million in 1986 (when 3.5 yuan approximately equalled US\$1), RSMCs constitute the major market mechanism in China's rural economy. They play a crucial part in distributing commodities and purchasing rural products for some 800 million people throughout the Chinese countryside (Zhu, 1986). However, in the face of (and indeed highlighted by) the success of the agricultural production responsibility system introduced in 1978, the RSMC system proved to be inadequate. Recognizing this deficiency, the Chinese government initiated reform of the RSMC system in 1982 with the aim of devel-

oping a better marketing mechanism to meet the needs of agriculture under the production responsibility system (Gao and Bi, 1986).

Currently, there is a wide range of research and experimentation being undertaken in China on various problems associated with RSMC reform. As yet, it seems no general conclusions have been drawn. So far as available data and the vast size and diversity of China allow generalization, this paper briefly reviews the development of RSMCs, describes their operation and appraises the reform underway since 1982. Suggestions are also made for further reform of the RSMC system.

Establishment and development of RSMCs

In July 1922, the first cooperative, Anyuan Miners' Consumption Cooperative, was established under the aegis of the Chinese Communist Party (CCP). This cooperative was mainly engaged in buying and supplying food for its miner members. Within a few years, various kinds of cooperatives emerged in the Genjudi (Revolutionary Base). Most of these were consumption and grain production cooperatives aimed at ensuring food supply and gaining the confidence of farmers and workers (Liu, X.Y., 1986). Such cooperative development was seen by Mao Zedong in his 1927 *Report on an Investigation of the Peasant Movement in Hunan* — reproduced in Day (1975, pp. 339–365) — as one of the most important revolutionary events to have occurred in China. Subsequently, in 1933, the Soviet Central Government of China promulgated its first Provisional Regulations on Cooperatives. These defined the cooperatives as organizations owned and managed by the farmers and workers. The fundamental principles of cooperative organization, according to the regulations, were that members should only join if they wished to, there should be mutual benefits among members, and management should be democratic (Zhu, 1986).

After the establishment of the People's Republic of China in 1949, the cooperative economy came into a new era. The new central government's policy was to support all kinds of cooperatives both politically and economically. The cooperative economy was seen to be as important as the State-sector economy. A national headquarters for the cooperative system was established in Beijing in July 1950. In the same year the headquarters drafted the Provisional Cooperative Law which stated that cooperatives constitute an economic system in which people unite themselves and protect their own interests (Zhu, 1986). This law, however, never became more than provisional. In 1954, the RSMC system was established and the national cooperative headquarters renamed as RSMC National Headquarters. Provisional regulations governing RSMC operation were formulated in 1955 and these, together with the Provisional Cooperative Law of 1950, strongly promoted development of the RSMC system as the farmer-based cooperative marketing mechanism for China's agriculture. In consequence, the RSMC system soon became one of the key ties linking

central, provincial, prefectural, county and local governments with farmers. RSMCs were particularly important in the allocation of key inputs often in short supply (e.g., fertilizer and seed) across the country and they procured rural products with great success. The RSMC system was thus very effective in guiding agricultural production and in initiating the socialist system during the early to mid-1950s.

In 1958, the 'Great Leap Forward' led to disastrous economic performance. Agriculture and the RSMC system in particular were affected badly. The RSMCs were amalgamated with State commerce and free markets in the countryside were closed so that the whole national market was monopolized by the State marketing system which served the collective production system poorly. One result of this situation was that excess supply of some goods co-existed with excess demand for others. Three years later, in 1961, a report on rural marketing systems was presented to Chairman Mao by Hu Yaobang (who later became Secretary General of the CCP). This report made Mao realize that RSMCs should be restored at least to the same status as in 1957 (Zhu, 1986). The following year, in 1962, the Central Committee of the CCP approved a *Resolution on the Problems of Trade* which was accepted, at the time, as legitimizing cooperative commerce as a part of the socialist economy (Zhu, 1986). Once again the RSMCs became effective and many agree that China's good growth performance from 1963 to 1965 was due in part to the RSMC system.

Unfortunately, the infamous 'Cultural Revolution' soon started and in December 1966 the provisional regulations of 1955 relating to local RSMCs were abolished, thereby enabling local government to intervene in RSMC operation. In 1970 the RSMCs were once again forced to become State-owned and their National Headquarters eliminated. The Headquarters were reestablished in early 1975 but again did not last very long. In 1978 the National Urban-Country Commerce Conference declared the property of RSMCs to belong to the State and, in February 1982, the RSMC Headquarters were incorporated as a department within the Ministry of Commerce which thus became administratively responsible to the central government for the RSMC system (Ministry of Commerce, 1983).

It must be pointed out that the fundamental reason for the elimination and restoration of RSMCs again and again lies in the fact that through all this period there had been no abiding conclusion in socialist theory on the necessity of the existence of such a cooperative system in China. The handed-down theory was that private ownership must transfer to collective ownership and collective ownership must transfer to State ownership. Thus, even though the RSMC system was restored several times after 1958, it never really functioned freely.

Structure and operation of RSMCs

Currently, RSMCs are basically administered by local and provincial governments and the Headquarters of the RSMC system is a department of the

relative to RSMCs; (c) competition, now promulgated by government as the important factor in developing the Chinese economy, is squashed under the present administrative system. This is because RSMCs and State commerce are largely engaged in separate markets with the former serving rural areas and the latter serving city areas, as shown in Fig. 2. Only in town areas (which in total are far less significant than rural or city areas) are both involved. In consequence, there is little opportunity for competition between State commerce and the RSMC system. Also, within both urban and rural areas, government administrative boundaries constitute market boundaries so that markets are further separated.

The operation of the RSMC system can best be presented in terms of the flows of goods and funds and the processes of staff appointment and decision making that prevail in RSMCs. The flows of goods and funds are highly related to business operations while staff appointment and decision-making processes give at least some flavour of administrative operation.

Flows of goods through RSMCs consist of two main streams, namely inflows

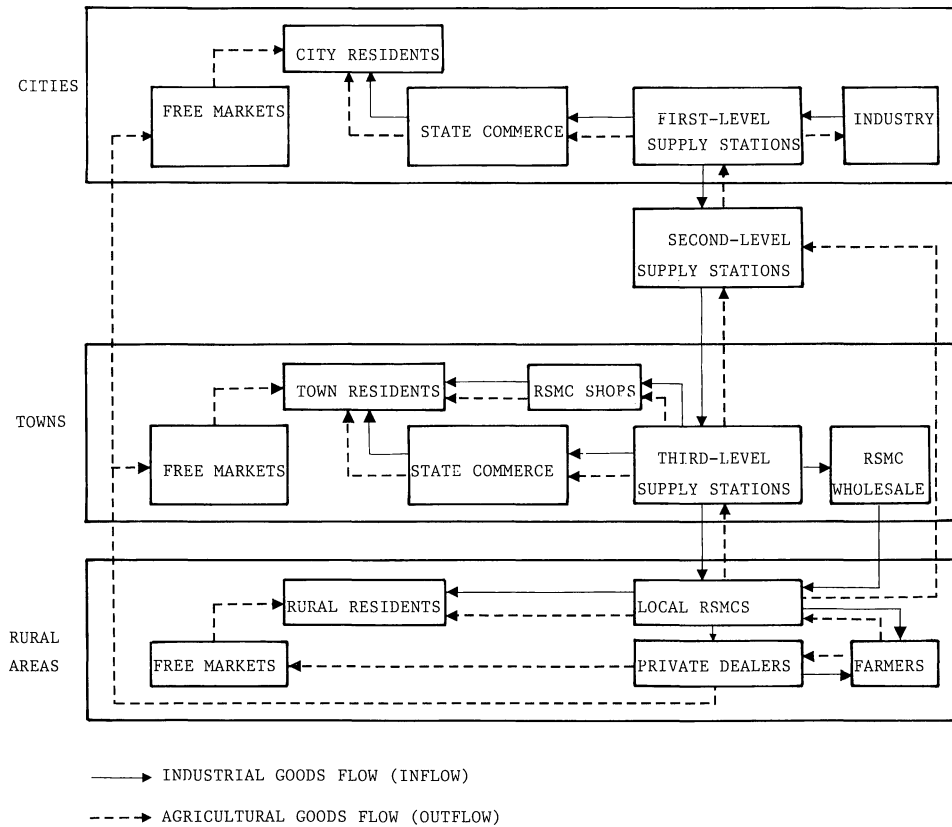


Fig. 2. Flow of goods through the RSMC system.

of industrial goods for sale and outflows of purchased agricultural products. Farmers are the dominant consumers of inflow goods and the unique producers of outflow products. The flow of goods is shown in Fig. 2. As far as inflows (i.e., industrial goods) are concerned, RSMCs act either as agents of government or as merchants according to the category of the goods involved (Ma, 1982, chapter 7). First-category inflow goods are those important production factors, such as coal, fuel and imported fertilizer, which are rationed by the central government and which RSMCs supply to farmers according to central government instructions. Second-category goods are consumption items generally in short supply, such as bicycles, sewing machines and the like. RSMCs obtain these through government allocation and sell them according to county and local government instruction. This is one of the areas where county and local governments are particularly prone to intervene in the operations of RSMCs. Other industrial goods, classified as third category, are supplied to farmers by local RSMCs depending on what the RSMCs can purchase from the third-level distribution stations (Fig. 2). In this, RSMCs are penalized in that the State-controlled distribution stations give priority to State commerce in allocating industrial goods other than those in the first category.

Analogously to inflows, outflows fall into three categories. First-category products, defined as those essential to people's lives and national development — e.g., grains, edible oil and cotton, were, until the introduction of the agricultural production responsibility system, totally procured by RSMCs from farmers with, as appropriate, an allowance for farmers' home-consumption needs. Second-category products, defined as important but not essential for people's lives and national development — e.g., pigs, eggs and tea, are purchased by RSMCs according to government plan. Other agricultural products are classified as third category. In the main, they are also purchased by RSMCs under the guidance of government plans.

While the arrangements outlined above are still generally true and encompass the majority of goods' flows in rural areas, significant changes have occurred since the introduction of the agricultural production responsibility system in December 1978. Farmers now operate in their own right rather than as members of a collective. If they wish, farmers can also now sell their over-quota production either to private traders or, less conveniently, direct to consumers via the now-permitted free markets. Also, since 1982, RSMCs have had a degree of latitude to choose and organize their own inflows by direct purchase which may involve industrial or trading organizations outside of the particular RSMC's government-designated district of operation.

The overall funding situation of the RSMC system in terms of sources of working funds in selected years is shown in Table 1. These data show that the activity of the RSMC system, measured in terms of working funds, increased nearly tenfold over the period from 1956 to 1982, the latest year for which information is available. Over this period, the contribution to total funding by

TABLE 1

Sources of working funds of RSMC system in selected years

Source	1956		1966		1976		1982	
	(10 ⁹ ¥)	(%)	(10 ⁹ ¥)	(%)	(10 ⁹ ¥)	(%)	(10 ⁹ ¥)	(%)
RSMC fund	10.20	18.2	1.22	0.7	15.62	4.8	16.51	3.0
State fund	10.34	18.5	38.66	21.7	90.54	27.6	111.88	20.1
Farmers' shares	3.36	6.0	3.91	2.2	3.66	1.1	3.82	0.7
Bank credit	25.86	42.3	104.66	58.6	182.83	55.8	342.06	61.5
Other ^a	6.16	11.0	29.99	16.8	34.87	10.7	81.39	14.7
Total funds	55.92	100.0	178.44	100.0	327.52	100.0	555.66	100.0

^aTrading surplus and miscellaneous sources.

Source: Ministry of Commerce (1983, pp. 523–525).

farmer members decreased from 6.0% to 0.7% while direct funding from State sources rose from 18.5% to 20.1% and that from banks (which are State-controlled) from 42.3% to 61.5%. Obviously, so far as sources of funding reflect influence, State influence over the RSMC system grew significantly over the period 1956 to 1982 while that of farmers declined to virtual insignificance.

The provisional regulations that governed the operation of RSMCs from 1955 to 1966 stipulated that their after-tax profit should be disbursed on the basis of at least 55% to a reserve fund, no more than 20% as dividends to members (i.e., farmer shareholders) and the remainder to capital construction and staff education, training and welfare (RSMC Headquarters, 1983). Annual data on these allocations are not available. However, the allocations made have not always conformed with the regulations (Ministry of Commerce, 1983). For instance, between 1958 and 1982 a portion of RSMC after-tax profit was transferred to local government. Nor were any dividends paid to members during the period from 1966 to 1982 when, like much else in the Chinese countryside, the RSMC system passed through a variety of circumstances ranging from nihilistic chaos to erethitic hiatus.

Staffing in each RSMC is specified under government plans. The staff are mainly State employees complemented by contract employees. State employees work on a regular basis. Their appointment and termination are entirely in the hands of local and higher-level government. Contract workers are normally rural residents. Until 1982, their appointment and termination depended entirely on local government approval of recommendations from the RSMC. Since 1982, the proportion of contract workers has increased and RSMCs have been given the right to appoint or dismiss some contract workers (Gao and Bi, 1985). In some local areas, a prerequisite for contract employment is the investment of a significant amount (say, ¥1000 or more) in the RSMC.

Before 1982, RSMCs had no right to set or change the types and prices of goods they handled, nor their staff numbers or wage levels. Decision making by RSMCs was generally confined to choices of brands of first- and second-category industrial goods, purchases of third-category goods and the arrangement of staff duties. The decision-making body was and still largely is the branch of the CCP in the RSMC, which was and still is under the leadership of the CCP committee of the local government. This has been the root cause of local government intervention in RSMC operation, particularly since 1966 when the provisional regulations governing the operation of the RSMC system were abolished. As noted elsewhere in this paper, however, since 1982 RSMCs have gained a limited degree of freedom in decision making.

Evaluation of RSMC reform

After the Third Plenary Session of the Eleventh Central Committee of the CCP held in December 1978, the introduction of the agricultural production responsibility system changed the mode of production entirely. This necessitated corresponding changes in the mode of commodity exchange. The progress of rural economic reform instantly pounded at the marketing system. Due to bottlenecks in the distribution and marketing channels, full advantage could not be taken of the tremendous upsurge in initiative of hundreds of millions of farmers. This led to the central government's decision in 1982 to again reform the RSMC system. In 1982 it was also written into the Constitution of the People's Republic of China that agricultural production cooperatives and other kinds of cooperatives, including supply and marketing cooperatives, do belong to the socialist collective economy of the working people (Government of China, 1982).

RSMC reform started in 1982. Emphasis was on restoration rather than reform, as reflected in the principles of the reform. These were promulgated as 'restoring three properties' (viz., willingness in joining an RSMC, democracy in administration and flexibility in management) and 'five breakthroughs' (viz., breakthroughs in the employment system, in the conditions of entry to cooperative membership, in the freedom of trade, in the distribution system, and in price policy). The guidelines of the reform are to change RSMCs from being government-run to being farmer-run and from State ownership to collective ownership. However, it is a common feeling in China that the RSMC reform is beyond being purely an economic phenomenon, and is therefore a more painstaking process than the introduction of the agricultural production responsibility system. Nevertheless, the central government has made its decision and the RSMC system is being reformed. Major elements of this process are steps to regain farmers' trust, administrative restructuring to give farmers greater control, changes to RSMC regulations to allow more local independence in managerial decision making and the breaking of administrative bar-

riers so as to give RSMCs greater flexibility in their operations. These changes and their effects can be described briefly as follows.

Payment of past dividends to regain farmers' trust

When RSMCs were first established, they were the farmers' own organization. Since 1958, however, the institutional structure, ownership and nature of RSMCs have been changed backwards and forwards several times. Especially when RSMCs were forced to join the State-sector of the economy, farmers lost all rights to operate the RSMC system. Moreover, up to 1982, farmers had not received dividends for their shares for nearly 25 years (Gao and Bi, 1985). They lost their cooperatives, shares, dividends and, most importantly, their trust in the RSMCs. To regain the trust and interest of farmers, the first step of the reform was to check the detailed list of RSMC share records and pay off the unpaid dividends. During 1982 and 1983, 300 000 persons were engaged in this campaign, which ascertained ¥360 million of shares held by 130 million farmers who were paid ¥120 million as dividends owed. This campaign aroused farmers' enthusiasm again with the result that by June 1985 they had purchased a further ¥1400 million of RSMC shares (Gao and Bi, 1985; Yang, 1986). This raised the percentage of farmer shares in the funding of the RSMC system from 0.7% in 1982 to 3.8% in 1985. In some areas, this percentage reached 50% (Xiao, 1986). Currently, 140 million rural families, or more than 85% of the total, now hold RSMC shares (Gao and Bi, 1985; Yang, 1986). In addition, reflecting farmers' new-found confidence, ¥800 million were also invested with RSMCs by their members. Without doubt, as the first step in the reform, this campaign succeeded in the sense that farmers started to treat the RSMCs as their own organization again, and to a certain extent, it also strengthened the RSMC system economically.

Administrative restructuring and resumption of farmer control

As an element of reform, RSMCs are now supposed to constitute a Members' Representative Assembly which elects the RSMC's Council. This body is meant to be responsible for setting the policy under which the RSMC is managed and is supposed to be the governing body in the RSMC. However, it will take time for this generally to become a reality, particularly in terms of RSMC Councils being fully elected and, as should be feasible, having a majority of members who are active farmers. According to incomplete statistics, at the commune level, 90 000 farmers are now members of RSMC Councils and 10 000 are executive members of the Councils (Xiao, 1986; Yang, 1986), corresponding to an estimated 30% and 10%, respectively, of the total positions. This is a significant move towards farmers becoming the owners and managers of RSMCs again and will help realize the reform's democratic principle. At the same time,

according to a survey based on 50 counties, the average age of RSMC Council officers has decreased from 50 to 40 and some 80% of Council officers now have junior or senior high-school education (Gao and Bi, 1985).

Changes to RSMC regulations

As another element of the reform, the Ministry of Commerce rules governing RSMC operation have been loosened with the aim of breaking the 'big rice bowl' (i.e., permanent employment and fixed-wage system) and decentralizing management. Among the RSMCs' planning, finance, price and employment systems, the employment system has changed most significantly. In some areas, the fixed-wage system has changed towards the responsibility system and employment is based on examinations and interviews set by the RSMC rather than through government appointment. The permanent status of employees has been replaced by a contract system. With these changes, farmers have more chance to be employed by the RSMC, something which normally could not happen prior to 1982. In consequence, by mid-1986, 350 000 farmers were employed in RSMCs as contract workers and many RSMCs are now managed by farmers (Anonymous, 1986b). These workers understand the farmer's mind and provide much better services.

Breaking administrative barriers to increase RSMC flexibility

In the past, RSMCs operated according to government orders. Everything had to be as specified in the plan passed by government to the RSMC. In consequence, the RSMCs, while nominally owned by farmers, did not serve farmers as well as they should have. Now, as greater power goes back to each RSMC's Representative Assembly, the RSMC is better able to supply what farmers demand and purchase what farmers produce. This change is of great significance not only to the rural economy but to the national economy, since the deficiency in China's infrastructure (e.g., in storage and transportation) is partially ameliorated by the extended scope of RSMC activities. This extension was possible only after RSMC reform started in 1982. Thus, between 1983 and 1984, RSMCs traded more than 6 million metric tonnes of grain and oil-seed. In 1985 they helped the State sector of commerce to store and transport more than 11 million metric tonnes of commodities. Also, RSMCs are now able to act as commission agents between industry and agriculture and between city and rural areas, an activity which had a trading volume estimated at ¥2900 million in 1985 (Yang, 1986). Since 1982, RSMCs have also set up more than 1700 trading centers so that producers and consumers can deal directly without any barriers (Xiao, 1986). This is a great improvement in the marketing system compared with the unbelievably tedious government allotment system that previously prevailed.

Suggestions for further RSMC reform

For the last 4 years, most of the effort has been devoted to recovery of the RSMC system from its distorted status. In a real sense, the reform is just beginning. As recently stated by the Director of the Rural Policy Research Center, which is administered jointly by the Central Committee of the CCP and the State Council of the People's Republic of China, China is seeking a new commercial system which must be more flexible in management than the existing system of State commerce while more controllable than private commerce which is seen as often ignoring overall social benefit (Anonymous, 1986a). To this end, the following suggestions are made for further reform of the RSMC system.

An RSMC law is essential

Historically, RSMCs have never enjoyed the luxury of legitimacy bestowed by a fully approved RSMC law. To date, at best, they have had to operate under provisional laws or regulations having less than full formal status; at worst, as during the Cultural Revolution, they have had to function under the hiatus of no effective laws or regulations at all. In consequence, the operations of RSMCs have suffered seriously from political interference, particularly from local government. This has even been true in recent years during which interference by entrenched anti-reform elements in local government has impeded the process of reform. Despite appeals from the central government for independent management of RSMCs, local governments still intervene in RSMC internal affairs even to the extent of arbitrarily dismissing RSMC-elected Council Chiefs and managers (Commentator, 1986). Concurrently, despite the recognition of cooperatives now accorded by the Chinese Constitution, State commerce has continued to try to monopolize profitable business and to shift non-profitable activities to the RSMCs. Accordingly, to prevent political interference and also to give protection against unfair activities by State commerce, it is essential that the status, role, function, property and rights of RSMCs be formally stated by law. This national law must also provide the framework for the implementation of specific policies aimed at ensuring the functioning of the RSMC system, for example, the provision of credit for their operation and their entitlement to any special tax arrangements.

RSMC administrative system must be restructured

A serious problem stemming from the present RSMC administrative system, as previously noted, is that commodities in excess supply in some areas are often in short supply in other areas. Too often, indeed generally, goods are

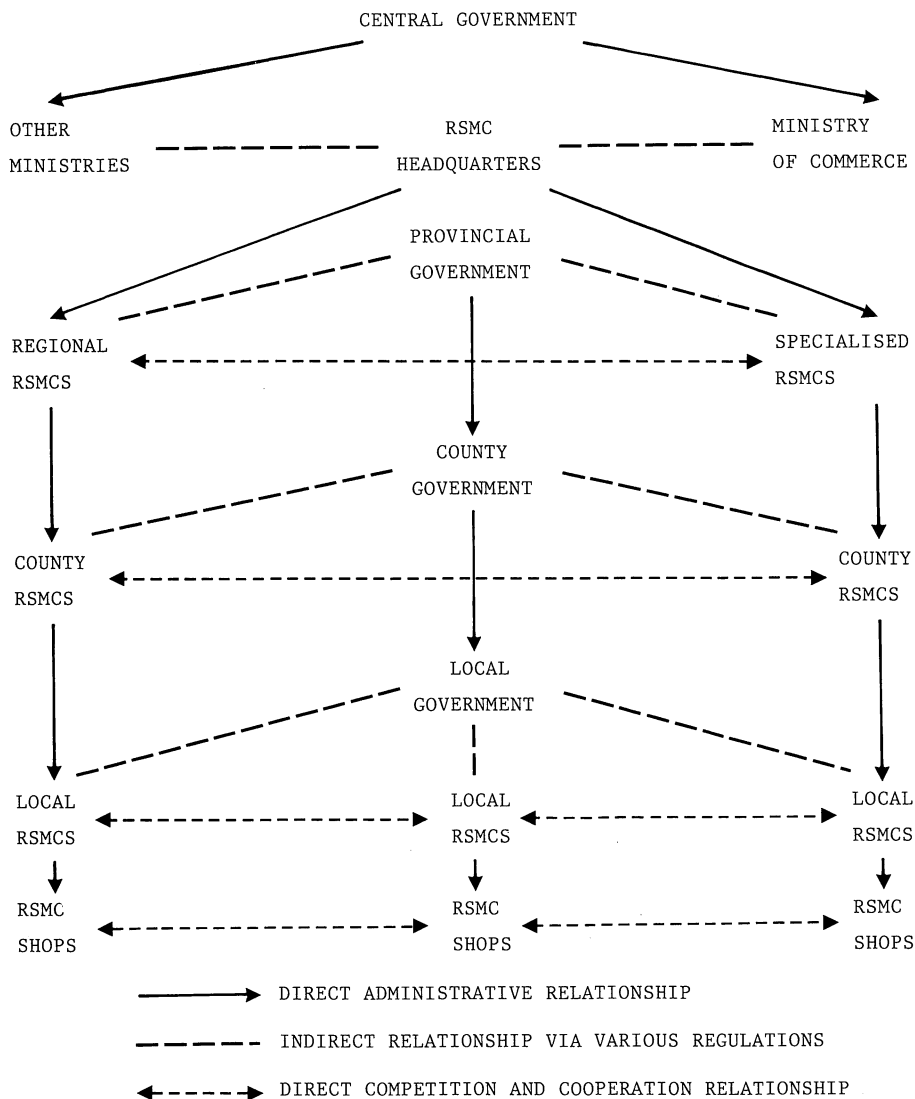


Fig. 3. Suggested new structure for the RSMC system.

produced simply to meet government quotas rather than to accord with market demand. More market influence and less planning control is needed.

A possible RSMC administrative system to meet this need is shown in Fig. 3. Under such a scheme, which can be contrasted with the present arrangement as shown in Fig. 1, there would be no direct administrative contact between RSMCs and government at any level and the RSMC system would be independent of State commerce. By removing administrative constraints on RSMC

operation, the free play of competition with State commerce as well as between RSMCs in rural markets would be facilitated. Under the proposed scheme, RSMCs are classified into two groups. One consists of general RSMCs handling all manner of goods and the other of specialized RSMCs oriented particularly to the needs of areas where specialized production bases are located.

Price system and overall marketing structure must be reformed

Although the espoused principles of RSMC reform include 'breakthrough in price policy', the RSMC system still largely operates on the basis of administered prices. The only change has been that RSMCs (and likewise State commerce) can now negotiate prices with producers or consumers for those goods (classified as third category) which are not covered by government plans.

To make real competition possible, it is essential that RSMCs and State commerce have the right to set prices for most goods and certainly for those in the third category. If desired, the government could control the degree of price movement by setting minimum and/or maximum prices. However, changes in price policy are only the necessary condition for competition. The sufficient condition to ensure that real competition prevails is to bring RSMCs and State commerce into the same markets. As shown in Fig. 2, the rural market is basically controlled by RSMCs and the urban market by State commerce. Obviously, this separation could result in monopoly if RSMCs and State commerce can set their own prices. To avoid this, RSMCs should be encouraged to operate as retailers in cities and State commerce encouraged to operate in rural areas. With the fast-growing activities of private commerce in both cities and the countryside, the change would make full competition between the three forces possible.

It should also be noted that the full benefits of competition can not be obtained unless the privileges held by State commerce are removed. These include privileges in accessing credit, in government budgeting, in the allocation of goods which are in short supply, in staff welfare, etc. The existence of such privileges places RSMCs in an unfair position relative to competition with State commerce. It may be easier to reform State commerce than to remove the privileges. One way to reform State commerce would be to transfer its ownership to a cooperative basis or even to private dealers. Alternatively, the State might retain the ownership of facilities but lease them to RSMCs or private traders. This would surely result in better service and greater efficiency. Several examples have recently been discussed in the *People's Daily* (Anonymous, 1986d; Liu, Y.D., 1986).

Role of farmers in the RSMC system must be strengthened

An RSMC is, by nature, a farmers' organization, so farmers should be the decision makers in RSMCs. At present, a large number of local government

appointees still occupy leadership positions in the RSMC system. Most of these cadres run RSMCs to their own ends rather than for farmers. This is the most serious impediment to further RSMC reform. The ideal solution would be for all government appointees in RSMCs to resign and be replaced by personnel selected by each RSMC's Council as elected by the RSMC's Representative Assembly. To ensure farmer control, at least 70% of the members of each RSMC Council should be active farmers and each Council should have an executive committee elected by the RSMC's Representative Assembly and of whom at least 80% should be active farmers. The executive committee, acting on behalf of the RSMC Council, would oversee operation of the RSMC and, subject to Council guidelines and approval, have the right to employ or dismiss employees, to reject or take government advice, to accept or refuse applications for membership of the RSMC, and to sign contracts with government or other agents.

Mode of profit allocation must be changed

Since RSMCs are engaged in both purchases from and sales to farmers, the interdependence between agriculture and the RSMC system is even stronger than otherwise. To promote further beneficial interaction between them, a link — beyond that implicit in members' dividends — should be established between agricultural profit and RSMC profit. This could be done by paying each farmer client of an RSMC an annual bonus according to the RSMC's profit and the farmer's volume of sales and purchases through the RSMC. Such a bonus would be in addition to the annual dividend each client would receive if he or she were a shareholder member of the RSMC. In terms of equity, such an arrangement would more justly differentiate trading members, non-trading members and non-member clients of RSMCs while also providing an incentive for non-active members to become active and for non-member clients to become shareholders. It would thus also reduce the danger to the cooperative of having non-active members who, for reasons of self-interest, might desire its dissolution (LeVay, 1983).

Scope of RSMC activities should be widened

With the introduction of the agricultural production responsibility system in 1978, the provision of agricultural extension became a major problem in China because, particularly at the village level, communal funding was no longer provided for extension services. Likewise, a large number of village-level mechanical service stations closed down. Concurrently, the rapid development of commercialized production coupled with a poor communication system has shown the need for market information services. Because of its central role as a marketing institution in the Chinese rural economy and its national network

of facilities, the RSMC system is ideally placed to help overcome such difficulties by widening its range of activities to include, e.g., an information service providing market news for both producers and consumers, an agricultural extension service to provide farmers with both technical and economic advice, and mechanical workshop and contracting services. Such activities would not only be important in developing China's agriculture but, as some have argued, would also be beneficial to both RSMCs and farmers (Anonymous, 1986c; Li, 1986).

Acknowledgements

With the usual caveat, the authors are grateful to two anonymous referees of this journal and Dr. R.R. Piggott for constructive comments.

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