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Economic Outlook for Communist China

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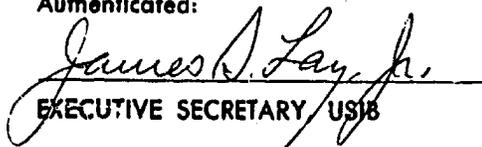
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ECONOMIC OUTLOOK FOR COMMUNIST CHINA

CONCLUSIONS

A. Economic activity in China, especially in the industrial sector, is being slowed by the Cultural Revolution. Nevertheless, military production and development continue to enjoy a high priority, and have been considerably aided by imports from the Free World.

B. Foreign trade has grown, and the non-Communist world now accounts for three-fourths of China's trade. China's balance of payments position has improved over the past two years. Support of North Vietnam has been substantially increased during the past year, but imposes no undue strain on the Chinese economy.

C. The economic outlook depends heavily upon the development of the political situation. During the next year or two, assuming a continuation of the present level of political turmoil, the economy seems likely to deteriorate somewhat, though probably not to the point of causing a sharp decline in industrial production, widespread unemployment, or acute food shortages. The weapons programs could be continued, though some stretch out in particular items might be necessary.

D. We think it unlikely that Mao will achieve sufficient political success in the Cultural Revolution to permit him to embark upon a new economic initiative similar to the Leap Forward. When Mao disappears from the scene, there will probably be a period of confused contesting for power during which economic recovery will be neither rapid nor sure.

E. The unfavorable food-population ratio, the economic costs and imbalances inherent in the military program, and the shortcomings

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of the educational system are problems likely to persist for at least a decade. A pragmatic regime could probably surmount them, but any successor to the present regime will also inherit some of the ambitious political goals of its predecessor. These will strongly affect the allocation of resources, probably at the expense of laying foundations for self-sustaining economic growth.

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DISCUSSION

I. THE POLITICAL SETTING

1. The political upheaval in China has complicated the analysis of China's economic performance, policies, and goals. The Third Five-Year Plan was to have begun in 1966, but a comprehensive plan has not yet been officially announced, and during the course of the Cultural Revolution little has been said concerning economic performance. Instead, attention has been focused on the political and social revolution. The leadership has been riven, and a new generation is beginning to assert itself. Cleavages are appearing between the young and the old, the students and the workers, the urban and the rural areas, and the regions and the center. Until a new order and consensus are established, economics is likely to be of secondary concern.

2. This situation reflects Mao's doctrines of social development. Mao fears the bureaucrat and the technician who, by their tasks and training, place a premium on stability and find reasons to halt revolutionary change. The cult of the amateur, embodied in "Mao's Thought," places more faith in arousing the talents and initiative of the common man than in following the advice of the highly trained specialist. It follows that Mao disdains material incentives for the more powerful—but ephemeral—force of ideological stimuli, and insists on the primacy of political enthusiasm over technical specialization. Prudent enterprise management in China has repeatedly found its cautious policies under attack by Mao. In brief, Mao is more a revolutionary leader than an economic planner.

3. The Leap Forward (1958-1960) stands as a stark example of carrying Mao's ideas to extreme lengths. Following Mao's order that "politics take command," a massive campaign of ideological exhortation elicited a nationwide outpouring of labor energies. Although this resulted in dramatic, but temporary, spurts in production, the lack of planning and coordination made the campaign ultimately self-defeating. Thus, faced in 1960 with crippling food shortages, cessation of Soviet aid, and a discouraged and disgruntled population, Peking had little choice but to pull back.

4. From mid-1960 to the end of 1962, Peking followed retreat and retrenchment policies to restore order and stability by curtailing investment, reducing or ending industrial subsidies, returning redundant urban labor to the rural areas, reviving private plots, restoring free markets, and decentralizing communes. Such pragmatic policies brought about a recovery of industrial and agricultural production that lasted into 1966.

5. We do not know whether Mao had to be pressured into these readjustments or whether he recognized the gravity of the situation and willingly acquiesced. Recent revelations confirm that there was continuing dissatisfaction among some leaders with Mao's leadership during the 1960's. It also seems probable that

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some top leaders were making decisions without first seeking Mao's approval. For his part, Mao was apparently growing more and more embittered as he felt himself being eased aside and his policies neglected. Thus, the collapse of the Leap Forward and the subsequent attempts at recovery contributed to the political tensions that erupted in the Cultural Revolution.

6. The radical policies of the Cultural Revolution have created an atmosphere conducive to radical economic initiatives similar to those of the Leap Forward. This would not be inconsistent with Mao's general notions; indeed, the political campaign was moved into the factories and the countryside in late 1966 and early 1967. However, this produced such confusion and disruptions to production that the regime moved rapidly to retreat from what seemed to foreshadow serious economic dislocations. With economic planning in a state of suspended animation, it seems likely that major economic initiatives will be postponed until some resolution of the political struggle is achieved.

7. In any event, the purge of the party and the general confusion about who is in charge have weakened the direction and control of the economy. Although the People's Liberation Army (PLA) has been ordered to help relay and enforce economic directives where the party and managerial apparatus has been discredited, the results have been less than satisfactory. The PLA has the ability to maintain order and discipline but lacks the necessary skills for administering complex economic activities. At the top, Premier Chou En-lai continues to maintain day-to-day operations in the governmental and economic bureaucracies, but only three of his 15 Vice Premiers remain in good political standing. Of the top level economic administrators, only Chou and Li Fu-chun seem to be currently acceptable to the Maoists. The weakening of the managerial and administrative apparatus is one of the major wounds inflicted on the economy by the Cultural Revolution.

II. PERFORMANCE

8. There seems little doubt that economic performance has declined this year, but it is impossible to quantify the decline.¹ Scattered indications of a gradual decline in economic efficiency are supported by Red Guard posters citing official admissions that production declined in January and February, and again in April. Nevertheless, there is no evidence suggesting that an economic crisis is near.

A. Agriculture

9. Thus far, the Cultural Revolution has had little impact on agriculture. Grain output in 1966 was at about the level of 1964 and 1965. Although grain production has recovered from the low levels of 1959-1961, it has yet to top the

¹ Peking has published little useful data since 1960. While detailed statistical analysis of the economy is thus out of the question, careful sifting of all available information gives us considerable confidence in detecting the general movements of the economy. With the exception of foreign trade, where good statistics are available, the conclusions of this section are drawn from analysis of what is necessarily an inadequate data base.

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record year of 1958. Meanwhile, population has grown by 15 to 20 million a year. Current reports of reduced rations and rising food prices, in both state and free markets, suggest gradually tightening supplies. Caloric intake per capita is probably somewhat less than in 1957, but we see no indications of either malnutrition or serious food shortages. Since 1961, Peking has augmented domestic food supplies by an average net import of almost five million tons of grain a year. We expect imports to continue at about this level.

B. Industry

10. The Cultural Revolution has halted the recovery of industry. Steady growth over the years 1963-1966 raised industrial production to a level above that of 1958, though still below the Leap Forward peak of 1960. This growth resulted mainly from fuller use of existing capacity. Some excess capacity still exists, particularly in light industries, but capacity is insufficient in other industries producing priority products such as finished steel. The revival of the construction industry in 1966 is suggested by the fact that, for the first time since the Leap Forward, all major cement plants in China were in operation. New construction was underway at military research and production facilities, electric power plants, chemical plants, petroleum facilities, and at mining sites. The disruptions of the Cultural Revolution probably have led to a slow decline of industrial output beginning in the last quarter of 1966.

11. Industrial policy during the past several years has been aimed more at increasing the range of finished products in support of major programs than in expanding basic industries. Priority attention is being accorded modern weapons, steel finishing facilities, electronic equipment, petroleum, and chemical fertilizer. Steel output has recovered to the point where most needs for ordinary steel products are probably being met. Deficiencies exist in the capacity to produce and fabricate refractory metals, high quality alloy steels, and a variety of finished steel products. China has been carrying on negotiations with Western Europe and Japan for plant and equipment to fill these gaps. In petroleum, output of crude oil has doubled since 1962, and China is now virtually self-sufficient in petroleum products; in 1966 only one percent of the total supply had to be imported. This remaining import need is for chemical additives to improve the quality of domestically-produced aircraft fuels and lubricants. Capacity in the chemical fertilizer industry increased from about 3 million tons in 1962 to 6-7 millions tons in 1966. Current emphasis is on the construction of small and medium-size plants, which may add about a half-million tons in 1967.

C. Transportation

12. China's transport system, which was overloaded and subject to periodic congestion during the Great Leap Forward, has been able in the last few years to meet basic economic needs without undue delay. The Cultural Revolution has caused only sporadic disruptions and backlogging of cargo at major rail junctions and ports. These difficulties have inconvenienced the economy in a

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fashion similar to the current agricultural and industrial dislocations, but no serious economic results have yet been identified.

D. Military Production

13. With the high priority given military production, China has developed weapons technology beyond what it received from the Soviets and is now making rapid progress. The Chinese have exploded six nuclear devices, have undertaken an ambitious missile program, and are attempting their own research and development (R&D) on a variety of weapons systems. Work on strategic missile systems is underway; MIG-19 fighter aircraft are being produced, and a follow-on aircraft will probably soon appear; an expanded surface-to-air missile deployment may be impending; medium bombers and submarine-launched missiles may also be on the way; finally, continued progress is being made on an early warning radar system and on conventional naval and land armaments.

14. China has carefully exploited the world's markets to obtain up-to-date technical data and equipment for industry. As Peking's shopping list grows, it includes a larger proportion of items that can be related to the advanced weapons program. COCOM regulations have generally prevented the Chinese purchase of military equipment, but the COCOM list does not cover many types of industrial equipment with either direct or indirect value to China's military program.

Since 1961, China has purchased more than half a billion dollars worth of machinery, equipment, and scientific instruments from Japan and Western Europe, and dependence on these sources will increase.² These imports not only aid the weapons program but help relieve the pressure on skilled manpower and equipment throughout industry.

E. Foreign Trade

15. Foreign trade has not been significantly affected by the Cultural Revolution. It grew about 10 percent in 1966, and at \$4.2 billion had almost regained the peak level of 1959. Although transport disruptions delayed shipping schedules in early 1967, the Chinese have been taking pains to meet their trade commitments.

16. Foreign trade increases in 1965 and 1966 were largely a result of continued growth in trade with the Free World, which now accounts for three-

²The following tabulation shows the value (in millions of dollars) of machinery, equipment, and scientific instruments imported by China from Japan and Western Europe. It excludes imports of transportation equipment.

YEAR	TOTAL	MACHINERY & EQUIPMENT	SCIENTIFIC INSTRUMENTS
1962	13.4	12.6	0.8
1963	16.6	14.3	2.3
1964	54.4	46.7	7.7
1965	158.9	138.2	18.7
1966 (est.)	195	170	25

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quarters of China's trade. Japan supplanted the USSR as China's main trading partner in 1965 and widened its lead in 1966. The impressive rate of growth of Sino-Japanese trade—52 percent in 1965 and 32 percent in 1966—has been roughly matched by that of Chinese trade with Western Europe. Hong Kong remains China's best source of hard currency. Total earnings from trade with Hong Kong reached \$475 million in 1966, and in addition, about \$75 million in nontrade earnings were received, despite a drop in remittances because of the Cultural Revolution. China's trade with Communist countries in 1966 continued the decline that began in 1960. Trade with the Soviet Union fell to about \$320 million, a decline of 23 percent from 1965.

17. China's balance of payments position has improved notably over the past 2 years. Foreign exchange and gold holdings increased by about \$50 million in 1966, reaching a level of \$450 to \$550 million. China purchased \$135 million of gold from the West in 1965 and \$40 million in 1966. China's indebtedness to the Free World totaled about \$265 million at the end of 1965 and was probably little changed in 1966. All this indebtedness is short-term. China has chosen not to ask for long-term credits, but could probably obtain them if it wished.

18. China's economic aid commitments to non-Communist countries fell from about \$310 million in 1964 to approximately \$120 million annually in 1965 and in 1966. The largest commitments in 1966 were credits of \$43 million to Cambodia and \$28 million to Guinea, and a \$20 million grant to Nepal. Actual drawings remained well below extensions, averaging about \$60 million a year over the last three years. China ceased announcing aid to Communist countries in 1965, but we believe deliveries increased in both 1965 and 1966.

F. Support to North Vietnam

19. Chinese aid to North Vietnam has grown steadily over the past year. China has been supplying small arms and ammunition, trucks, industrial raw materials, semimanufactures, food, and other consumer goods. There are also four antiaircraft divisions and many thousands of engineering troops in North Vietnam, and some fighter aircraft may have been supplied. China has increased the shipment of a broad range of items to replace bombing losses, including rails, construction materials, spare parts, and drugs and medicine. Chinese Communist capabilities for providing these materials and manpower far exceed commitments made so far. This aid, together with Soviet aid transiting China, has increased the burden on the rail net, but it still preempts only a small fraction of Chinese rail capacity. To the best of our knowledge, the flow of aid has been maintained with only minor interruptions in spite of China's internal political turmoil.

20. Peking has also made substantial investment in defense and related construction in Southern China. This construction, which is part of a general program of strengthening defenses along the periphery, is concentrated on new airfields and main line railroads. Yunnan Province has now been linked to the main rail net of China, thus permitting direct shipments between the two

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without a detour through North Vietnam. The new construction also provides an additional route for supplies to North Vietnam.

III. PROBLEMS AND PROSPECTS

A. The Short-Term Outlook

21. Over the past 17 years, the regime's most impressive achievement has been its use of the party as a political and economic apparatus to harness the vast energy of China's enormous population. Now, with the party in disorder and the government bureaucracy under attack, this control has been enfeebled. Under these conditions, it will be difficult to keep agriculture and industry functioning as a coordinated whole. It is already evident that economic efficiency has declined. Planning and managerial control are likely to be even further weakened if the purges continue, and the military lack the adaptability to take over the functions of the disabled party.

22. Thus, any estimate of the general outlook for the Chinese economy must of necessity be conditioned by the political outlook. During the next year or two, assuming a continuation of the present level of political turmoil, the economy seems likely to deteriorate somewhat, though probably not to the point of causing a sharp decline in industrial production, widespread unemployment, or acute food shortages. The weapons program could be continued, though some stretch out in particular items might be necessary. Unless political developments upset the foreign trade patterns which have been developing, foreign trade will probably grow. Choices in allocation of resources, especially among military uses, export programs, and industrial and agricultural investment will be made more difficult because of general political chaos and the decline of central authority.

23. It is possible that the present indeterminate political situation will be ended by Mao's early reestablishment of sufficient control to embark on an economic phase of the Cultural Revolution. Should he succeed, we would expect this to be similar to the Great Leap Forward, including a reduction in material incentives and great stress on exhortation. If unrestrained by the moderates, Mao would be likely to abolish the private plots and free markets. But this would almost inevitably lead to severe food problems and thence to apathy and a decline in morale and efficiency.

24. While we certainly cannot rule out such an evolution of the economic situation, we think it unlikely. We do not believe that Mao will achieve a clear-cut resolution of the political struggle; indeed, it is possible that he intends the struggle to drag on. Even if he thought that the time had come to move the revolution into a new phase, any step in the direction of radical economics would almost certainly generate new opposition from those, such as Chou En-lai and perhaps much of the PLA leadership, who have supported Mao thus far.

25. Even when Mao disappears from the scene, political stability is unlikely and economic progress will be neither rapid nor sure. There could be a long

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period of confused contesting for power; at the very least there will be an interregnum before a new leadership is consolidated. If a coherent leadership emerged, it might adopt less grandiose national goals, make more concessions to social demands, and attempt to restore some sort of administrative order. It might to some extent scale down and stretch out China's military programs. But it would probably still give priority to advanced weapons, and China's hostility towards the US would be likely to persist.

B. Economic Considerations for the Longer Term

26. The problems characteristic of a nation seeking industrialization and modernization are present in China, but are often sharply exaggerated by China's ambitions. Never before has a nation so industrially backward and with so large and poor a population attempted so strenuously to acquire the military strength and stature of a major world power. China's gross national product (GNP) is considerably smaller than that of Japan or France; in its per capita GNP and the portion of GNP contributed by industrial output, China's economy resembles that of India. In pursuit of its goals over the past 17 years, China has utilized over one-quarter of its GNP for investment and military expenditures, and has cut corners to increase the impact of this effort. Agriculture has been slighted, and industry is disproportionately oriented toward military production. Striking progress has been made in advanced weapons development, but this success has strained China's resources and talent and has led to new calls for shortcuts. It is in this setting that China's deep economic problems must be understood.

27. *Food-Population Ratio.* China at best faces only slow progress in reducing population growth. Some success has been achieved in reducing the birth rate in the cities, but it will take a long time to accomplish a significant reduction among the peasantry, who constitute over 80 percent of the population. Moreover, even a highly successful rural birth control program would secure only a limited reduction in fertility, and this would tend to be offset by increasing life expectancies. Thus there seems little likelihood of any notable change in the rate of population growth over at least the next decade.

28. The Chinese intend to raise agricultural output over the next decade mainly by greater use of chemical fertilizer. Peking has already sharply increased the supply of chemical fertilizer, both from imports and domestic sources. In order to increase agricultural production commensurate with population growth, China needs an annual increment of roughly two million tons of chemical fertilizer. China is not currently building large chemical fertilizer plants, and unless new plans are quickly put into effect, much of the requirement will have to be met from imports. Moreover, China will shortly, say by 1970, face sharply increased requirements for farm investment to use that fertilizer, including additional irrigation, improved transport and distribution, and more intensive technical measures. China may face trouble if it is not prepared to divert the necessary resources to underwrite these investments and to sponsor suitable changes in the organization of farm production.

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29. *Economic Costs of the Military Program.* The success of the weapons program has been at the cost of withholding resources from the civilian sector and delaying the growth of a general industrial base for the broader needs of the economy. There will be some benefits to civilian industries from the spin-off of R&D in the weapons field, as well as in the stimulation of industries in ancillary fields. But these benefits are greatly outweighed by the loss in general economic development that is an inevitable consequence of the high priority given to the weapons program. In any event, the costs of the military program are now around 10 percent of China's GNP. Overall costs will substantially grow as advanced weapons systems move into production and deployment, and R&D costs will increase as the Chinese move further beyond designs furnished by the Soviets. Production costs will be high because China will have to create the industrial backup in machinery and skills that is already available to most industrialized nations. Moreover, China's limited supply of scientists and technicians has been concentrated on military R&D, and general scientific research is suffering as scarce scientific talent is applied to solving urgent practical problems of military production.

30. *Shortage of Educated Manpower.* Peking has vastly expanded school facilities and enrollments in China and for the first time has provided its young generation with an education. But at the same time it has interfered with education by recurrent political campaigns. The most recent and extreme example is the closing of China's universities and the proposed overhaul of the curriculum throughout the school system to concentrate on Mao's works. Moreover, the system of higher education is handicapped by the siphoning off of professional personnel for high priority military programs, and the balance among various types of professional and technical training is not consistent with China's specific needs. These weaknesses will necessarily slow the achievement of economic efficiency as the economy attempts to advance to levels where both professional competence and technical skills are required.

31. These problems—the unfavorable food-population ratio, the economic costs and imbalances inherent in the military program, and the shortcomings of the educational system—seem likely to persist for at least a decade. Any regime which comes to rule China will have to cope, not only with the damage which is being done by the Cultural Revolution, but with these almost intractable facts of economic life. A pragmatic regime could probably mobilize China's resources in such a way as to keep the economy moving at a moderate rate of development and provide some modest increases in the low standard of living now prevailing.

32. But any regime will inherit some of the political goals as well as the economic problems of its predecessor. It will likely try to continue the military program, compete with the USSR for influence in the Communist world, and retain its antagonism to the US. These will strongly affect the allocation of resources, probably at the expense of laying foundations for self-sustaining economic growth.

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