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Economic Prospects for Communist China

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ECONOMIC PROSPECTS FOR COMMUNIST CHINA

THE PROBLEM

To assess the problems and performance of Communist China's economy, and its prospects over the next few years.

NOTE

Firm information on Communist China remains so sparse that precise economic analysis is not possible and even broad judgments are subject to error. The Estimate should be read in the light of this general caution. Annex A gives a brief description of our information on the Chinese Communist economy.

CONCLUSIONS

A. The Chinese economy has recovered somewhat from its 1960-1961 low, but its prospects are considerably worse than in 1957.¹ Any Chinese government would face monumental economic problems resulting from the huge and growing population, inadequate arable land, and the low level of technology. The problems of the Chinese Communists are compounded by their own past errors, their ideological compulsions, the break with the Soviet Union, and extreme nationalism. (*Paras. 1-10*)

B. Grain output in 1963 was no greater than in 1957, when there were some 75 million fewer people to feed. Peiping's mismanagement and the post-1960 decline of Soviet support have grievously hurt the industrial sector; total output in 1963

¹ In the following discussion we use 1957 as a base year for comparison because it was the eve of the Great Leap Forward, and because the per capita grain output in that year represents a level of production that provided farmers and factory workers an adequate diet, made grain imports unnecessary, and permitted the export of modest amounts of grain and other agricultural products.

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remains far below the 1959 peak. A few priority industries, such as those supporting agriculture and the petroleum industry, are operating at close to capacity, but many suffer from unbalanced development, technological deficiencies, and shortages of parts and raw materials. Foreign trade is at the lowest point since 1954. That with the Soviet Union has declined more than 60 percent since 1959, and China has become a substantial importer of food from the Free World. (*Paras. 11-26*)

C. We believe that the Chinese Communists will seek and obtain additional credits and technical assistance from the Free World, but in relatively modest amounts. We do not believe that diplomatic recognition by France and other Free World countries will alter this picture substantially. (*Para. 27*)

D. We believe that agricultural production in the next few years is unlikely to grow much faster than the population, and that industry will grow at a rate well below what was achieved in the mid-1950s. The Chinese are likely to continue to devote more attention to agriculture in both their domestic and import programs, but will probably not divert enough resources from industry and the arms program to put agriculture on a sound footing. We believe that the Chinese will be anxious to revert to a policy favoring industrial development, and will be prone to do so prematurely. We believe that difficulties will accumulate in the economy, within the leadership, and between the regime and the people. We thus do not believe that China can become a modern industrial state for many years. China's direct military threat to the West will remain limited, but China will continue to be a major force in Asia, and a crucial menace to its Asian neighbors and to Western interests in the area. (*Paras. 29-39*)

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DISCUSSION

I. COMMUNIST CHINA'S PREDICAMENT

1. Communist China's economic problems are similar to those of many other underdeveloped states but on a vastly larger scale. China has a huge and rapidly growing population, insufficient arable land, and a low level of technology. Its output barely supports consumption at subsistence levels, and there is little surplus to provide the capital resources needed for economic growth. Any Chinese government would have great difficulty in coping with these problems. However, the Communist regime's insistent ambition rapidly to become a major industrial-military power, to transform Chinese society in the Marxist image, and to play an influential international role has placed staggering burdens on the economy. This has led to the present disorientation of the Chinese economy and to disarray in the regime's policies.

2. In the first few years after the civil war in 1949, the Chinese economy benefited from the establishment of a central government controlling all mainland China, and from the considerable enthusiasm of a war-weary population yearning for a "new China." With Soviet assistance considerable growth in the economy was achieved, much of it from making better use of existing capacity. Then, dissatisfied with the pace of the First Five-Year Plan (1953-1957), underestimating the importance of Soviet assistance, and carried away by their own theories, the Chinese leaders launched their country into the disastrous Great Leap Forward. Simultaneously, they began the challenge to the policies and leadership of Moscow which led, among other things, to the withdrawal of practically all Soviet technicians from China in 1960. When the bumper year of 1958 was followed by poor crop years and hastily conceived and uncoordinated policies produced chaos in industry, the formula for economic disaster was complete.

3. Agriculture has recovered somewhat from the worst years 1960 and 1961, when the per capita diet in some months probably fell to 1,400 calories per day. Moreover, industrial capacity has grown in the last five years, the transportation system is greatly improved, and the supply of trained industrial workers is larger. Debts to the Soviet Union have nearly been paid off, and the control system of the Chinese Communist Party remains intact. On the other hand, China has become a net importer of grain and has possibly some 75 million more people to feed. Economic collaboration with the Soviet Union has come to an end, no firm economic plans have been formulated, and the industrial sector is in wide disarray. The regime can no longer count on a positive response to new programs from the population, or even from the cadres. On balance, the prospects for the Chinese economy are considerably worse in 1964 than they were in 1957.

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II. POLICY AND PERFORMANCE

4. Shocked by the economic crisis of the years 1960-1961, China's leaders have made important retreats from previous policies. They are now giving more attention to agriculture and have postponed their attempts at a rapid buildup of industry. They have backed away from mass conscription of labor for large scale construction projects. They have in effect ended the communes, and have even allowed some private initiative in the production of food. These relaxations, coupled with large imports of grain, enabled the economy to survive the nearly calamitous food shortages of 1960-1961 and to make modest gains during the last two years.

5. Peiping's leaders have not yet devised a comprehensive, long-range economic plan, but they have drawn up general guidelines for China, giving higher priority to agriculture, establishing more realistic production goals, and emphasizing quality as well as quantity. The regime is seeking more accurate statistical reporting and tighter control of industry, while permitting greater decentralization of agriculture. A most revealing example of the leaders' willingness to re-examine and revise their policies is their recent reinstatement of a birth control campaign.

6. Political and social factors sharply limit both the choices of economic policy open to China's leaders and the effectiveness of any methods adopted. Their ideology keeps them committed to collectivist principles. They still maintain that communes will help to solve China's problems, though in fact they are relying on a system of small collectives. They give material incentives only grudgingly. They continue to divert the time and energy of the workers and the peasants from production to ideological indoctrination.

7. Economic advance is also hindered by the assertive nationalism of Peiping's leaders and their ambitions to make China a great world power. Their defiance of Moscow has robbed China of technical assistance which, given their xenophobia, is not likely to be replaced from any other foreign quarter on anything like the same scale. Grandiose nationalistic aims have overridden economic rationality, especially as concerns Peiping's ambitious advanced weapons program.

8. The leaders' attempt to mobilize China's vast human resources has been made difficult by past abuse. They are seeking to overcome public and party apathy by greater appeals to nationalist and anti-Soviet sentiments, by assigning veteran rural cadres to production units with which they have special ties of locality or kinship, and by holding back mass campaigns in certain instances where they grossly interfere with work to be done. It is clear, nonetheless, that Peiping will face growing problems in attempting to impose its will on a dispirited population and the party rank and file.

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9. The regime must also cope with sharply increased unemployment and underemployment. Industry cutbacks have put some 10 million factory workers out of jobs in the last three years. The attempted resettlement of many of the surplus workers on farms has aggravated the problem of surplus labor in the countryside; the peasants resent the influx of urban workers, and many of those sent to the country return to the cities, despite regime disapproval.

10. Another serious problem for the regime arises from severe cutbacks in high school and college enrollment. This was intended to restore high standards of instruction, but the constriction of educational opportunity can be expected to have serious consequences. Five million young people have been dumped into the labor market in the last two years before their education could be completed; they not only add to its already severe dislocations but advertise the failure of earlier high hopes for education as the key to progress. The regime is now showing special concern for growing cynicism among the youth.

A. Agriculture

11. Total grain production in 1963 was probably about 175-180 million tons, approximately the same as in 1962 and in 1957. The diet improved significantly over the preceding year both qualitatively and quantitatively reflecting the fairly substantial recovery in the 1962 harvest over that of 1961 and the continuing increase in the production of vegetables and other subsidiary foods on private plots. In 1963 the regime sought to increase the acreage and yields of cotton, the production of which in 1962 had fallen to about half that of 1957. However, we estimate that bad weather kept the increase in cotton output to less than 10 percent, and total output remained far below the 1957 level. As a result of the inadequate 1963 harvests, consumption levels in 1964 will not improve.

12. The regime appears to have concluded that China's agricultural problems cannot be solved by additional labor or expansion of farm land, but will require technical improvements which will take many years and substantial capital investment, especially for chemical fertilizers. Peiping does not look for large gains from elaborate mechanization and is stressing rural electrification and the manufacture of animal drawn machinery, hand tools, and water pumps. It recognizes the need for increased investment in water conservation, flood control, and irrigation, and is already devoting considerable effort to repairing and improving irrigation facilities in areas where potential yield is highest. Plans to improve seeds and land management, though not requiring large amounts of capital, will be effective only in the longer term.

13. China's leaders have apparently decided that chemical fertilizer must be the primary ingredient of any agricultural expansion, and

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recognize that it will be expensive. The Chinese have begun a program to increase the supply of domestic fertilizer; among other things they are converting a large number of machine building plants to support the fertilizer industry. Domestic production of chemical fertilizers increased sharply from 2.1 million tons in 1962 to an all-time high of about 2.9 million in 1963; in addition a record 1.7 million tons was imported. These quantities are still small in relation to China's vast needs. The average quantity of chemical fertilizer applied per hectare is about five percent of that in Taiwan, and some two to three percent of that in Japan. The expanded use of chemical fertilizer will require the Chinese to improve their cultivation practices, make better use of available water, and produce more pesticides and better varieties of seed.

14. The problem of the food-population balance is also being attacked by the reinstitution of a birth control program. The program has been put into effect slowly and carefully so far, but it may be expanded in the spring of 1964. As an experiment, maternity benefits and some child allowances have been withdrawn in a few cities. Though abortion and sterilization are openly advocated, the medical means and qualified specialists for launching a large-scale program are not now available. Contraceptive methods advocated by the government may have found some acceptance in the cities, but the difficulties of indoctrinating the rural population effectively are great. Birth control is likely to be of little help toward meeting China's food-population problem in the near future.

15. It will be extremely difficult for Peiping to improve the food population balance, even if the Chinese population growth does not accelerate over its present annual rate of about two percent. To raise the per capita production of grain to the 1957 level by 1967, the Chinese would have to increase their output of grain by almost five percent yearly, a performance we believe unlikely. Even a three percent annual growth—which would restore the 1957 level of per capita grain production in 10 years—would need sustained high investments and sound programs in support of agriculture.

B. Industry

16. Communist China's industry has also been hit hard; industrial production, though somewhat above 1957, remains far below its 1959-1960 peak. Shifting priorities have reduced the demand for many basic industrial commodities, and have left considerable capacity idle. In other industries, poor planning has caused an uneven development of capacity among various stages of production. Some plants are not in operation or are operating below capacity because of the absence of technical assistance and parts once supplied by the USSR, and others are suffering from a lack of raw materials.

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17. On the other hand, a few industries are receiving special attention and are on the whole operating at rates much closer to capacity. Petroleum, modern mining, timber, and the industries supporting agriculture fall into this category. The Chinese are working hard to relieve their dependence on outside sources for petroleum. We estimate that the total production of crude in 1963 was about 5.5 million tons and of products some 5 million tons—the highest levels yet reached in China. Construction at refineries, oil fields, and storage facilities tends to confirm the high priority given to this industry. Though no acute shortages are apparent, the petroleum situation is tight, and China remains dependent upon the Soviet Union for imports of highly refined petroleum products.

18. Steel is an example of an industry which is suffering from unbalanced development. The total production of crude steel in 1963 was approximately the same as in 1958, or 8 million tons. Another 8 million tons of capacity lay idle because of a lack of rolling facilities and reduced demand by consumers of steel, particularly in construction and machine building. Alloy steel, on the other hand, is receiving high priority, and production is probably at rates close to capacity.

19. The production of equipment for military use was hard hit by the withdrawal of Soviet technicians in 1960.² It has the highest priority, but the manufacture of the more sophisticated military items is being held back by a lack of technical competence and by shortages of key imported components. Electronics production is expanding, with the major share going to the military. There has probably been some increase in production of land weapons and ammunition over the low levels of 1960–1962. The production/assembly of combat aircraft and large naval vessels has stopped. Construction for the advanced weapons program, which was virtually stalled after the Soviet withdrawal, has picked up since 1962.

20. Total production in light industry in 1963 was less than in 1957, largely because of shortages of raw materials. This was most striking in the industries using agricultural raw materials; for example, two-thirds of cotton textile capacity is idle. Production of consumer goods from industrial raw materials has suffered less from such shortages and stands about 35 percent above the 1957 level; these products, however, comprise only about a third of the total output of light industry.

21. The shifting pattern of demand and priorities has had a particular impact on cement, electric power, and machine building. At least 40 percent of cement capacity is probably idle, because of the low level of construction in China. There was probably a slight increase in electric power production from 1962 to 1963, but power plants are, on the aver-

² An estimate on Communist China's military establishment is scheduled for March 1964.

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age, operating at only about 50 percent of normal rates because of reduced demand. Production in the machine-building sector has suffered from a lack of spare parts and the absence of Soviet technical support, and is far below peak levels.

22. The regime seems to recognize that any attempt to resume and sustain production on a wider front must rest upon an improvement in technology. China probably has more than 200,000 reasonably well trained engineers, but a wholly inadequate number of scientists and engineers capable of designing or adapting industrial plants. Without foreign training and assistance, it will take the Chinese many years to remedy this deficiency. The Chinese are permitting many more of their scientists and technicians to attend international scientific gatherings, but only a few hundred Chinese students are still studying abroad, almost all in the Soviet Union.

C. Foreign Trade

23. Communist China's economic difficulties are clearly reflected in its foreign trade, which now stands at the lowest level since 1954. The composition of China's trade has also shifted radically. Since 1959 China has changed from a net exporter of food to a substantial net importer, and by 1962 machinery imports had dwindled from one-half of total imports to only one-tenth. Trade with the Soviet Bloc has fallen by more than 60 percent since 1959.

24. China will almost certainly wish to increase its imports of machinery, equipment, and raw materials over the next few years. It is unlikely to seek or obtain substantial imports from the USSR. Some may come from other members of the Bloc. But in order to import these items in quantity China will have to look to the Free World. The Chinese have sharply increased their efforts to obtain technical data and market information in the West, and have exhibited considerable interest in expanded imports of capital goods. In recent months, they have bought equipment on medium-term credits, particularly chemical plants and oil refining equipment.

25. China's ability to increase imports from the Free World is sharply limited by its foreign exchange position. Reserves of Free World currency at the end of the year were probably about \$150 million. China's gold holdings are about the same size. China will find it difficult to increase its foreign earnings. The foodstuffs for which it could most readily find foreign markets are in general those which will be least available for export. Its textile and mineral exports, though more plentiful, will not be easy to sell in highly competitive world markets.

26. A number of Free World countries now appear eager to sell machinery and equipment to Communist China on credit. China owes

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\$125-\$150 million to Western suppliers for past grain purchases. This debt is not large in relation to China's exports, and its record of repayment has been good. The Soviet debt has been sharply reduced, and is scheduled to be fully repaid by 1965. Unless there are some good harvests in the next few years, however, China may be forced to continue substantial food imports. This could impose some limits on Western or Chinese willingness to undertake capital equipment transactions on credit.

27. We believe that the Chinese Communists will seek and obtain additional credits and technical assistance from Western Europe and Japan, but in relatively modest amounts. China's weak foreign exchange position and its low earning capacity reduce its attractiveness as a credit customer. For its part, China would be reluctant to go heavily into debt to the Free World, to receive many foreign technicians, or, more generally, to open up its economy to Western influence on a large scale. Diplomatic recognition by France and other Western countries will facilitate commercial dealings with China, but we do not believe it will alter this picture substantially.

28. Over the past decade, China's foreign aid expenditures have averaged roughly \$100 million annually. Ninety percent of this amount goes to Bloc countries, principally Albania, North Korea, and North Vietnam. This level is not likely to decline significantly in view of existing foreign aid commitments. It could increase as the result of intensified Chinese competition with the USSR for influence in underdeveloped countries.

III. GENERAL OUTLOOK

29. Since the collapse of the Great Leap Forward, the economy has operated on annual plans aimed at redressing past excesses and returning the economy to an even keel. We doubt that the Chinese Communists will long remain content with operating on a year to year basis. As soon as they consider that the worst is over and conditions are appropriate, we believe that they will come up with a new plan covering several years and providing for greater investments. In 1963, and again in 1964, the regime indicated that conditions were not ripe for such a plan. We have no clear evidence as to when a long-range plan will emerge and no assurance as to the economic policies it will reflect.

30. Conceivably, the Chinese Communist regime might adopt far harsher techniques of austerity and pressure in an effort to squeeze out more quickly the resources needed for economic growth. The regime must recognize, however, that there is very little more which can be extracted from the Chinese population by measures short of those which would cause millions to starve. The regime would be concerned

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that such a course might arouse sufficient dissidence to threaten its control at home, its position in the Communist world, and its image abroad.

31. We are reasonably certain that the present Chinese leaders will not adopt the kind of policies which we believe would give China the best chance for sustained economic growth. One of these would be an allocation of resources which subordinated all other programs to the development of agriculture to a greater extent than has been done over the past three years. Another would be the adoption of further measures to maximize incentives and productivity, such as further encouragement of private plots, the expansion of private trade, and restoration of private small-scale enterprise. The Chinese would also have to adopt foreign policies which would maximize China's ability to import machinery and technical assistance from abroad. We do not believe that the policies described above will be adopted, because of the intensely nationalistic and Marxist outlook of the Chinese leaders and the dangers they would see in permitting the degree of relaxation required.

32. The importation of chemical fertilizer and fertilizer plants, if combined with a vigorous domestic program to boost agriculture and with prudent administrative policies, would help agriculture recover and in due course contribute once again to industrial growth. The Chinese Communists could probably secure, and find politically acceptable, the relatively modest foreign credits and the relatively few foreign technicians required. This relatively modest program for giving priority to agriculture would nonetheless require that the Chinese postpone any major modernization of industry, since most of China's own resources, as well as the limited foreign assistance probably available, would have to be concentrated in the agricultural sector. Moreover, it would probably take two or three years for such a program to show results, and barring unexpected good luck, at least as many more before China could achieve 1957 per capita levels of agricultural output.

33. If, by contrast, primary emphasis were put on industry, the Chinese would need extensive help in technology, capital equipment, and raw materials from abroad. For the first year or two, the principal requirement would be a substantial improvement in the supply of technicians and of industrial and agricultural raw materials; subsequently, after idle capacity had been put back to work, there would be a need for new investment in capital equipment. The required imports would probably be too costly for China, and Peiping would be most reluctant to accept the large number of foreign technicians needed. Moreover, the neglect of agriculture would require the import of grain in amounts beyond China's ability to finance, and there would be a great risk of food shortages more serious than those of 1960-1961.

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34. The above considerations suggest that the Chinese Communists have little room for maneuver in their economic policy, in part because of a paucity of means, but also because of their own political and ideological compulsions. Many of their difficulties would be eased by an end to the Sino-Soviet conflict, or by a broad expansion of economic relations with the Free World. Neither of these can be wholly excluded, but both seem unlikely.

35. We believe that China's leaders will not commit themselves wholly to a course which goes all out for either industry or agriculture. They will probably try to give agriculture and the industries supporting agriculture enough resources to prevent a repetition of the food crisis of 1960-1961, but will stop short of concentrating resources to the extent we believe necessary to put agriculture on a sound footing. Commercial relations with the Free World will probably be expanded considerably, but they will not be intimate or on a large scale. Peiping will almost certainly not relinquish its armaments program and will probably continue to spend considerable effort and money in trying to overcome industrial imbalances and technological shortcomings. We believe that the Chinese will be anxious to revert to a policy favoring industrial development and will be prone to do so prematurely.

36. China's economic prospects over the next few years are bleak. Even if the regime pursues sensible economic policies, progress will be slow, if only because of the lead times required to mount major agricultural or industrial programs. The weather will be more important over the next few years than anything the Chinese can do. Two or three years of good harvests would ease the situation somewhat, permitting China to use its excess capacity in light industry, and freeing foreign exchange for the purchase of capital equipment. We believe, however, that agricultural production is unlikely to grow much faster than the population, and that industry will grow at a rate well below the level achieved before the Great Leap Forward. We think that the economy will remain sluggish, and that this will entail accumulating economic, social, and psychological problems.

37. Debate over the rate and method of economic advance has in the past produced substantial differences within the Chinese leadership. The radicals, who launched the Leap Forward and the commune ventures in mid-1958 and maintained the programs against major opposition in mid-1959, have not appeared to suffer a loss of influence or position since they abandoned these policies in 1960. Differences over economic policy presumably still exist, although the identities of both issues and protagonists are obscure. Such differences may sharpen as the regime attempts to formulate comprehensive development policies to meet its persistent economic problems, and as time takes its toll of the uniquely cohesive but aging Chinese leadership.

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38. We are unable to assess China's long-term economic prospects with confidence, a condition we almost certainly share with Communist China's leaders themselves. Under favorable circumstances, China could realize modest recovery and economic growth. If circumstances are not favorable, we foresee an increasingly bleak future. China's problems are unprecedented in character and magnitude. The nearest approximation is the experience of the USSR a generation ago, yet China's starting point is poorer and its difficulties greater. We believe that, in strictly economic terms, mainland China has the potential for considerable economic growth, but the political and social pre-dispositions of the Chinese Communist leadership are such that this potential is unlikely to develop for the foreseeable future.

39. There is not a direct relationship, however, between China's economic fate and its position in the world. Realization of its latent potential would magnify its importance. The more likely darker future means that China will not become a modern industrial state for many years. It also means that China's direct military threat to the West will be limited, and that China's image and example will not be an attractive one. This does not mean, however, that China's influence will not grow in the world, or that its overshadowing presence will not remain a crucial menace to its Asian neighbors and to Western interests in the area.

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ANNEX A

APPRAISAL OF ECONOMIC INFORMATION ON COMMUNIST CHINA

1. The information available for an appraisal of the Chinese Communist economy is fragmentary, uneven in coverage, and uncertain as to reliability.

2. We have reasonably reliable information on: (a) the location, status, and, in some cases, the rate of operation of many large and medium-size industrial installations; (b) Chinese trade with both the Bloc and the West, based on statistics of the countries which list exports and imports by country and type of product; (c) the general course of economic plans and policies as revealed in announcements by the Chinese Communist leadership; and (d) the general history of Soviet support to the economic development of China based on reports concerning the Sino-Soviet dispute.

3. The following information is uncertain and spotty: (a) current levels of production and consumption of grain and other major agricultural commodities; (b) current capacity and rates of production in major industries; (c) current levels of operation of the transportation system and the condition of its equipment; and (d) the size and rate of growth of the Chinese population.

4. Hardly any reliable information is available on: (a) the statistical data available to the leadership and the specific numerical targets for the economy; (b) major alternative economic policies as seen by the leadership group, and divisions within the leadership as to the wisdom of these policies; (c) reserve stocks of grain, petroleum, and other important commodities; and (d) the specific magnitude of the economic resources devoted to investment and to defense.

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