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% U.S. Consulate
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Dear Mr. Rogers:

A major economic crisis faces Communist China, as economic conditions in much of Communist territory get progressively worse instead of better. Natural disasters, the Kuomintang blockade, civil war devastation and the confusion of political readjustment are contributing causes, but many Communist economic policies, motivated primarily by political rather than economic considerations, are delaying real recovery and intensifying the hardships which this crisis imposes on ordinary people.

Food is the dominating problem in the lives of millions of Chinese. Even in good years China cannot feed her population, and many "little people" starve. This is a bad year. Before the Winter is over starvation will probably be widespread throughout many parts of China. The annual agricultural cycle in North China (to cite one area) began this Spring with a bad drought. This was followed by pests and hail storms. Finally, in the Summer, the rains came in a concentrated downpour which inundated fields and created floods. This concatenation of disasters has reduced agricultural production in North China to a low level. Some crops could not be planted. Others withered on the stalk, were ravaged by insects or rotted in flooded fields. In some areas the probable crop is estimated to be thirty percent, or less, that of good years. North China's normal food imports from abroad have been cut off, not only by the blockade but as a matter of government policy to conserve foreign exchange for "more vital" imports. The short-run effect of land redistribution in many places has been a lowering of agricultural output, because farmers are often reluctant to sow what they may not be able to reap. Heavy grain requisitions to support the Communists' armies of three to four million men have in many areas not only stripped the countryside of food surpluses but have eaten into subsistence stocks. By early Summer reports were reaching Peiping of villages where orders had been issued to all farmers to conserve their corn cobs to grind into roughage for mixing with grain. By mid-Summer farmers were coming into Peiping from the surrounding countryside to buy grain, and there were a few days when rickshaw coolies, who often buy their food on a day-to-day basis, found the shelves of the food shops empty. Food prices spiraled slowly but surely upward.

The Communists have met these natural disasters with stoicism and have made concerted attempts to push well-digging, the use of insecticides, the construction of stronger dykes and the organization of cooperative action on the part of farmers to alleviate the disasters and maximize agricultural production. On the other hand, despite the

critical, and worsening, conditions they seemed more concerned in many respects with initiating long-run policies than with concentrating on pressing immediate problems. This year, for example, they have carried out an extensive program of encouraging, by direct pressure as well as by incentives in the form of tax reductions, the planting of agricultural raw materials such as cotton and peanuts to increase national self-sufficiency and encourage industrialization. They claim that cotton acreage in North China has been increased to two million acres, which they say is sixty percent more than last year. Because China lacks foreign exchange this policy would be a sound one if foodstuff production could simultaneously be increased to meet domestic needs. To push through such a program in a year of calamity, however, can only mean that food shortages will be more serious, and the suffering of ordinary citizens greater, than otherwise would be the case. The food situation in North China has been alleviated to a limited extent by the transfer of surpluses from other areas, but this has been on a smaller scale than it could have been. Manchurian foodstuffs, including soya beans, corn, rice and vegetable oils, have, in fact, been traded to the Soviet Union for industrial equipment, motor vehicles, oil and manufactured supplies, thereby increasing the overall food deficit.

The Communists, more than any other group in China, emphasize the primary importance of economic problems - rehabilitating the economy, increasing production, raising the standard of living, reducing the great contrasts in wealth, developing industry. In the territory which they now control, however, they inherited an economy which had run down during years of war, civil war, inflation and inept government control. This legacy of economic chaos would have presented almost insuperable problems to any regime, and the Communists have started attacking a few of the problems with great energy. Their approach in many cases, however, seems to be more basically political than economic (a distinction the Communists themselves would probably declare invalid, but one which I think can be made). They seem to be more concerned with what kind of economic policies "should" be followed, and what kind of economy "should" be developed in the long-run, than with the immediate short-run effects of their methods.

Primary emphasis in the whole economic program of the Chinese Communists at present is on industrialization. Their thinking on industrial problems is often naive, unrealistic or Utopian, however. In a major policy speech delivered on April 12 this year, for example, Jen Pi-shih, member of the party's Central Committee, stated, "If we are to make China entirely independent economically, we must not only work to restore undermined industry within three to five years, but also must work to increase, in accordance with a plan, the specific gravity of industry in the national economy from ten percent to thirty or forty percent in a period of ten to fifteen years. China must have a considerably larger machine manufacturing industry which will produce large quantities of machinery, cars and ships needed for the development of industry, mining and communication enterprises. China must achieve a status where her own industry will be able to produce

artillery pieces, tanks and airplanes needed for national defense. Only then may we say that China has not only achieved an independent status economically but is also in possession of sufficient strength to protect her own sacred borders that are not to be invaded. Only after industry has been developed, production techniques improved, the cost of production gradually reduced and the output of products in large quantities made possible will it be possible gradually to promote the living level of the working class, as well as that of the people, to consolidate the alliance between workers and peasants, and to really manifest the function of leadership by the cities over villages and to lay down a strong economic foundation for the future transition to Socialism." Other official statements have followed this same line. The proposal to make the Chinese economy thirty to forty percent industrial in ten to fifteen years would be Utopian under ideal conditions; under existing conditions it is absurd. The emphasis on building heavy industry is unrealistic; to the extent which heavy industry can be created at this stage in China's development it will be at great cost to the economy as a whole and to the average consumer. The main explanation why the Communists are following this line in their policy, despite the fact that it is "uneconomic," is revealed in the quotation above. They want to achieve what they consider to be "economic independence" for both political and military reasons (the Kuomintang has emphasized heavy industry for military reasons also), and to lay down the "economic foundations for Socialism."

Communist leaders seem to show little understanding of the tremendous amount of capital equipment needed for extensive industrialization, and no one has revealed where large amounts of capital can be obtained. It is generally conceded that not much will be forthcoming from the Soviet Union, and the Chinese Communists are cutting themselves off from the major potential sources of aid for China's industrial development. They are generally suspicious of close economic relations with any countries outside of the Soviet bloc, and although Czechoslovakia and a few other countries might help them, the prospects for assistance from within the Soviet bloc are slim at best. In Mao Tse-tung's article On People's Democratic Dictatorship, published on July 1, he stated that the idea of U.S. and British aid is "a childish thought at present." His further statement that, "The Communist parties and progressive parties and groups in these countries are now working to bring about business and even to establish diplomatic relations with us," was interpreted by some people as a hedge against the future possibility of aid from the West, but he went on to say that "... we belong to the anti-imperialist front headed by the U.S.S.R., and we can only look for genuine friendly aid from that front, and not from the imperialist front." The Communists have a phobia about "Western imperialism" which includes much which would be considered "normal economic relations" in the West, and as a consequence they are following policies which, unless changed, will isolate them from much of the international economy. The whole trend in their thinking seems to point toward increasing autarky, even though China is in no position to attempt extreme "economic independence."

There is a tremendous contrast between the grandiose plans and the inescapable poverty of the Communist regime. For example, while leaders talk about building heavy industry out of thin air, the North

China People's Government is forced, on a practical level, to carry out an economy program in government agencies by encouraging employees to save paper, make their own glue and ink, and reduce the use of electric lights. Faced with the realities of the existing situation, the Communists are adapting their approach in a number of ways. Many of the major cities in Communist hands are in a desperate position, as a result of the Kuomintang blockade in addition to all the other unfavorable economic factors, and the Communists have responded to this with a policy which may be one of the greatest "back to the country" movements in history. They assert, for example, that two million people must move out of Shanghai alone. In mid-July in Peiping, Chou En-lai pessimistically stated that "the Chinese people must be mentally prepared for a blockade of eight to ten years and must stand this new test." Some steps have been taken to move factories out of the coastal industrial centers to industrial cities in the interior; the Communists have pointed out that this would place them nearer to sources of raw materials such as cotton, but haven't publicly discussed the difficulties which would arise from the shortage of electric power, skilled labor, finance capital, and so on, in the interior. Also in July, Lin Piao in Central China announced a reversal of policy, and explained the necessity for taking "steps different from the Northeast and North China." He said in Central China their emphasis must be on village work and that, "we must first create and develop the prerequisite conditions for the cities and afterward directly develop the cities." He emphasized, however, that this "certainly is not in opposition" to the general party line, and that the party's emphasis was still upon cities and industrialization. Despite adjustments, therefore, the basic policy line has not changed.

The general economic program of Chinese Communism for the present historical period is included in the theory of "New democracy." Certain negative goals are set up: the elimination of "feudalism" in agrarian China, "bureaucratic capitalism" in urban China, and "Western imperialism" and "compradore capitalism" in China's economic foreign relations. These goals involve policies of land redistribution and confiscation of "bureaucratic capital." According to the Communists the national economy, during an extended transitional period "between 'semi-feudalism' and 'semi-colonialism' and ultimate Socialism," is to be composed of three elements: government enterprise, cooperative enterprise, and private enterprise. This economic program is expressed in many slogans such as "benefits to both public and private industry" and "consider the interests of both labor and capital."

Formulae of this sort are generally accepted by Chinese (except, of course, for vested interests which oppose any change which might harm their position), and few people oppose the idea of land reform, the elimination of huge monopolies dominated by Kuomintang officials which have squeezed smaller private enterprises into a difficult position, or the direct participation of government in utilities, transport, mining and heavy industry. Socialization in these fields is in line with the thinking of most Chinese. The implementation of these formulae is a different matter, however. There are wide differences of opinion among non-Communists as to the methods which should be used

and the fields in which the government should operate at this stage. Many specific policies which the Communists are now following are not only arousing resentment but are compounding the confusion which already exists in the economic scene, particularly in urban areas.

The Communists, in areas which come under their control, immediately take over all "bureaucratic capital." This is merely a transfer of control from the Kuomintang, and officials closely tied to its regime, to the bureaux of the new regime. The Communists are not confining the field of their ownership and control to large-scale enterprises, however. Although they affirm the principle of private enterprise in other fields they are themselves becoming well-entrenched in all industrial fields, including light consumer goods and processing industries. Economic and financial difficulties in the remaining private industries have multiplied in the process of economic transition from the old to the new regime. As a result many have been forced into a position of dependence on government aid, and government controls and supervision relating to production, prices, wages and profits are increasing steadily.

Government monopolies have been set up in many fields, and government control of raw materials reduces the independence of private entrepreneurs. Price competition by government industries and agencies puts private business men and producers in a difficult position, even when the government is concerned with price stabilization rather than eliminating private competition. The government is also extending its direct operations into the retail field. Large government-run food and department stores and government-supervised cooperatives are beginning to play a significant role in the realm of small business. This is particularly the case in Manchuria but is also growing elsewhere.

Large government trading companies, organized on a regional basis, are taking over an increasingly large share of domestic trade. These companies buy food and raw materials in the country and manufactured goods in the cities and exchange them on a barter basis. Trade between the major geographical regions in the country is gradually coming more and more under the monopolistic control of bureaucratic organizations of this sort. In a recent barter arrangement to cite one example, the North China Trading Company exchanged cloth, yarn, kerosene, gasoline, caustic soda and glass for cotton, peanut oil and tobacco from the Central China Trading Company. Similar inter-regional barter arrangements are being made all the time between state trading organizations.

The Chinese Communists are hard-working, remarkably incorrupt and adaptable in learning many of the details of running economic organizations. They have also taken over technical personnel from the old regime. But they lack the qualified personnel to take over so much of the economy rapidly and manage it efficiently. As a result they have made innumerable mistakes and blunders. There are also inherent difficulties in a situation where government and private enterprises

are in competition with each other which are difficult to solve under any circumstances. In simple terms perhaps the greatest difficulty is how to develop government enterprise without stifling private enterprise. Another difficulty is how to fit government planning and private industry together in any workable scheme. The Communists are neophytes in the field of economic management, and the net effect of much of what they are doing is to seriously set back that portion of the economy which is not in their hands - which, of course, still includes the vast majority of small producers and traders. In China, because industrialization is still in its infancy, the cycle of bust or boom is not so evident as in industrialized nations. When the economy is in a bad way it doesn't fall apart completely; it simply slows down and creaks and groans more than usual. This is what is happening in urban centers in Communist China.

In the field of labor organization and labor-management relations the Communists are attempting to develop a subsidiary political weapon to give indirect support to the implementation of economic policies. They hope eventually to have strong unions under centralized Communist direction including all industrial laborers. In industries where they have already been organized such unions exert considerable pressure on management. Pressure for increased wages has, in fact, added to the difficulties of hard-pressed private entrepreneurs, even though the Communists' present attitude is that labor must subordinate its self-interest to the national welfare and concentrate on increasing production rather than raising wages. "Factory management committees" representing both labor and management have been set up in government-run enterprises, but so far haven't been introduced extensively into private industry; in the government factories where they now exist the government-appointed factory manager has the veto power in all decisions.

The difficulties under which private industry and trade are operating are added to by the Communists' tax policies and legal practices. Private enterprises are subject to a number of heavy taxes, and the rates are not only variable and unpredictable, but often retroactive taxes are levied for past periods with little reference to income during those periods. The practical effect of the taxes in many instances is to force businesses out of operation. To cite an extreme example of irresponsible taxation, a foreign business man in Tientsin carried out an import-export deal for a government agency for a two percent commission. Almost immediately afterward he was requested to pay a two percent tax on his gross (not net) operations during the period in which this transaction was the only one he had made. As a result his entire profit was taxed away, and since he had incurred certain charges which didn't appear on his books until later he was left with a net loss and a bitter taste in his mouth. This sort of thing is not confined to foreigners, however. A Chinese woolen goods manufacturer, for example, discovered that after paying the price for raw wool from the Communist agency which was the only place he could get it, paying his laborers higher wages which the Communist-led union insisted on, and paying the taxes which the Communist government imposed, he was expected to sell his product to a Communist trading company at a price

which would not cover costs. The fluid legal situation also introduces a large element of insecurity into private enterprise. The Communists have abolished previous laws, but new laws have not yet been drawn up in many cases. So-called "people's courts" are the final authority in all disputes, and their decisions are sometimes fair and sometimes arbitrary.

Continuing price inflation and money depreciation would make economic revival difficult under the best of conditions, even though in many respects the Communists have shown themselves more intelligent and ingenious than the Kuomintang in financial and fiscal policies. The Communists have tried, with limited success, to slow inflation by tying wages to basic grains such as millet. They have instituted bank deposits in grain and cloth equivalents to reduce the depreciation of savings. They have maintained an official foreign exchange rate which is closer to the real values than previously was the case. And, of course, the restoration of connections between the cities and their agricultural hinterland has facilitated the interchange of commodities and improved the situation somewhat. But inflation continues, even if at a slightly slower rate than previously, because the Communists still rely on printing presses to produce unbacked currency, and because commodities, including food, are still in short supply. To the extent that the economy is on a "millet standard" inflation is retarded, but to the extent that it is still a money economy inflation continues unchecked. One measure of this inflation is the fact that between February and August the local currency value of the U.S. dollar in Peiping increased from 600 to 2,700, even though the commodity purchasing value of the U.S. dollar decreased during the same period. By July the local currency prices of basic commodities were almost doubling every two weeks. Between July 15 and July 30, for example, the price of millet, which is the staple food for poor people in much of North China, increased from \$150 to \$260 per catty (a catty is slightly more than a pound) in Peiping.

In foreign trade even more than in domestic industry the Communists are instituting government monopolization, and they seem to be aiming at a general system of state trading. The trade regulations for North China issued in March put foreign trade on a barter basis under government supervision. These regulations, although still on the books, have gradually been modified in practice, and the trend has been away from barter, because the government has tried to regulate profits and has found that it is possible for traders to conceal considerable profits abroad under a barter system. At the same time that there has been this tendency away from barter, however, the government has gone into the import-export business itself to an increasing extent. In Tientsin, major port of North China, for example, the government has not only established a legal monopoly of the pig bristle trade, which formerly made up roughly sixty percent of Tientsin's exports, but by various indirect methods - such as buying export goods at high prices at the source of supply - it is getting an actual monopoly of most other important commodities as well. Many private traders are being forced out of business or compelled to work for the government on a commission basis for regulated profits which are hardly worth bothering about.

The volume of overall trade has dropped very low. One reason for this is the Kuomintang blockade which even in Tientsin, where the effect is much less than in Shanghai, has stopped a great deal of trade, particularly coastal trade. Another reason is the Communists' ignorance of international trading methods. The most important reason, however, seems to be the Communists' apparent willingness to let trade slump while they establish political control over it to the maximum extent possible under existing conditions. They are accumulating large stocks of export goods which they probably will try to sell on their terms at a future date. The Communists are not unwilling to make a few modifications in their policies to encourage trade - for example in North China they have abolished export taxes after widespread objections - but they seem to be willing to sacrifice a good deal to achieve government control over trade.

In a few economic fields, the Communists, despite all difficulties, have recently made great achievements and strides toward reconstruction. Perhaps their outstanding success has been in restoring railway communication. Their success in a few fields, however, and even their agrarian reform, cannot hide their overall failure to-date to get the territory under their control on the road to economic revival.

If the Communists could talk themselves to prosperity they would be having a boom. They use every conceivable psychological weapon to spur "production drives" - factory competitions, awards for "labor heroes," special praise for "model workers," and so on. These methods seem to have a certain amount of success, but they are not enough to overcome major difficulties or solve basic problems.

The Communists, although not following policies of flagrant discrimination against foreign enterprise, have shown in many ways that they are interested in maintaining only those foreign business and trade establishments which they cannot do without. As a group the foreign businessmen in places such as Tientsin are the most discouraged of all private entrepreneurs. Most of those who still remain are hanging on at a loss, and they are not optimistic about the future. The majority seem to feel that they will ultimately be forced out - although a few British firms, particularly shipping companies, are notable exceptions.

The overall effect of Communist policies is that government control is being extended at a rate which seems faster than that contemplated in the theory of "New Democracy." By pushing long-range policies with politico-economic objectives, furthermore, the Communists are tending to ignore, or to actually complicate, critical short-range economic problems. The economy which the Communists took over was in bad shape, but there is great disappointment among the public over the fact that revival has not yet taken place and economic deterioration continues. The situation is becoming more and more difficult for private enterprise, and the coming year will be one of great economic hardships for the common people in much of Communist China.

If the Communists are not able to make progress toward economic improvement and stability in the future, this fact will eventually have political repercussions. Unorganized popular unrest and discontent usually grow in China as economic pressures increase. Although at present there is no focus for this sort of discontent to form an opposition, it might develop if economic deterioration goes on. Factionalism within the party on the basis of disagreement on economic policy might also develop under those circumstances. Furthermore, local centers of resistance to the Communists, if they continue in existence, would take on a significance which few have at present, if the Communists were internally weakened by their inability to improve the economic situation in their territory. The effect on the Communists themselves of continuing economic decline could take any one of several forms. The Communists might modify their policies under public pressure. On the other hand they might institute tighter political controls to force their policies through. If they continue their present line advocating rapid industrialization with a minimum of foreign assistance, political controls would almost inevitably tighten. Such a policy, furthermore, would have to be paid for mainly by China's peasants, and the entire character of the Chinese Communist Party, and its position in the country, might change. The Communists have not been in power long enough, however, to prove or disprove their ability to carry out the economic policies which they are now following. It is only possible to wait and see.

Sincerely yours,

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