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Five Anti Campaign IV: National Finance

INSTITUTE OF CURRENT WORLD AFFAIRS

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Dear Mr. Rogers:

The Five Anti Campaign, which convulsed the major cities of China during the first half of 1952, produced a large amount of revenue for the state treasury. It was an extraordinary and discriminatory tax levy imposed upon the bourgeoisie of the country, and it was an essential element in the general fiscal policy of the government.

Many Chinese businessmen bluntly assert that the Chinese Communists' main aim in the campaign was to shake-down private enterprise to obtain revenue, and they dismiss all other aspects of the campaign as ideological window-dressing. Their opinions are not unprejudiced, of course, but there is no doubt that financial motives were extremely important in the campaign.

The Chinese Communists now operate with an enormous (for China) national budget which in the past two years has expanded rapidly due to increasing military expenditures, a great enlargement of the bureaucracy and government payroll, and extension of government activities into all spheres of national economic life. In the opinion of financial experts in Hong Kong, government revenues have not increased at the same rate as expenditures, and budget deficits have crept upward. The Five anti Campaign, and similar mass campaigns during the past three years, have served as disguised, special tax levies to supplement regular state revenue.

In 1950, the Chinese Communists carried out a Victory Bond Campaign which netted the equivalent of perhaps US\$140 million. During this campaign, the main burden of which fell upon urban businessmen, coercion and intimidation were employed to force "voluntary" subscriptions, and quotas were assigned to business and other urban groups. This forced loan is still being serviced by the government, but it provided much-needed revenue when it was collected. In 1951, the government promoted a nationwide Arms Donation Campaign to obtain funds for the purchase of airplanes and heavy military equipment (no explanation was given of how local currency donations would be converted into foreign exchange to purchase these arms). According to summary figures released in June of this year, this campaign brought in the equivalent of about US\$250 million. Although people of all strata throughout the country were pressured to give donations, the main burden of this levy again fell upon urban classes, and businessmen in particular. The East China region contributed 38.3 per cent of the total donations from all over the country, and Shanghai alone gave 15.3 per cent of the total. This year the Five Anti Campaign in the cities involved payment to the government of back taxes, "illegal profits", and fines. This time the target was exclusively the business class, and it is conservatively estimated that the government's receipts from the campaign were more than double those of last year's donations campaign, or the equivalent of over US\$500 million.

The financial importance of these special tax levies can only be evaluated in relation to the general financial situation of the government in China. This is difficult to do because of the lack of trustworthy data; facts about China's government budget and national income have always been vague and incomplete, and this is particularly true now due to the secrecy surrounding Chinese Communist policies. (Budget figures are classified as "state secrets".) It is possible, however, to make "educated guesses". The best estimates which I have discovered in Hong Kong are those made by a Chinese financial expert, formerly a department head in the Central Bank of China before the Communists' takeover, who left the mainland two years ago and since then has been working on a study of the Chinese Communists' financial system which he hopes eventually to publish. The data which follows on the Peking Government's budget summarizes a few of his conclusions, arrived at by involved calculations based upon the percentage figures and the few dollar figures made public by the Communists. He will admit that his figures are subject to errors, but after checking against other available sources I believe that even making allowances for some errors his general conclusions are probably correct.

The Chinese Communists' estimates for their central government budget in 1950, according to this study, amounted to approximately US\$2,785,000,000 in expenditures and US\$2,264,000,000 in receipts, leaving a deficit of approximately US\$520 million, or 18.7 per cent. (These and subsequent US dollar figures have been converted from Chinese currency at official rates which are artificial but are nonetheless a general standard for conversion.) Actual expenditures and receipts during 1950 exceeded these estimates, however. The Korean war resulted in higher taxation as well as larger military and government expenses. The real central government budget in 1950, according to this study, probably involved expenditures of about US\$4 billion and receipts of about US\$3 billion. Local government finance, at that time separate from the central budget, may have raised the totals to US\$4.5 billion and US\$3.5 billion, leaving a deficit of US\$1 billion. Victory bonds helped to make up roughly one seventh of this deficit, and Soviet aid from the 1950 loan agreement provided a small amount (the Soviet loan promised US\$300 million over a five year period), but issuance of paper currency was necessary to make up the remainder.

During 1951, the size of the budget, and of the deficit, are believed to have increased still further. The combined central-local expenditures probably amounted to US\$5.5 billion, while combined receipts lagged behind and amounted to only US\$4 billion, producing a deficit of US\$1.5 billion. The Arms Donation Campaign brought in almost double the receipts of the Victory Bonds, but this larger amount still only made up about one sixth of the increased deficit; the remainder, apart from whatever was provided by the Soviet loan, again had to be provided by currency inflation.

Although these figures may not be completely accurate, I believe they present a general picture of Peking's fiscal problems, and the budgetary significance of the Five Anti Campaign can be understood in this context.

There are reasons to believe that the total national budget and the deficit will be larger in 1952 than in 1951. Consequently, the Chinese Communists have been faced with the problem of extracting larger and larger sums of money from those sectors of the economy which have still had a little fluid reserve left. The Five Anti Campaign provided a part

of the answer to the problem.

There are no official figures on receipts from the Five Anti Campaign, but US\$500 million is believed to be a conservative estimate. This is the consensus of several leading Chinese banking sources in Hong Kong, as well as the former Central Bank expert whom I have already cited. The latter believes that the Chinese government received from the campaign something between US\$500 million and US\$800 million in the form of relatively fluid assets - cash, foreign exchange, gold, silver, merchandise, and materials - and an additional amount in the form of fixed capital taken over from private enterprises. Although the Peking Government has not made public the details of how such receipts are handled, it is certain that they enter the balance sheet of the national budget in some form or other; if they are handled in the same way as similar receipts derived from the Three Anti Campaign, the fluid assets are treated as "state income" and the fixed capital as "state investments". In any case, it is probable that the Five Anti Campaign contributed close to 10 per cent of the total national budget for the current year.

The magnitude of the Chinese Communists' budgetary problems may be put in clearer perspective if present figures for the estimated budget are compared with the size of pre-war budgets and estimates for the total national income. Pre-war central government budgets in China varied between roughly US\$300 million and US\$500 million. They are now estimated to be about ten times that large. (This is one measure of the steady socialization of the Chinese economy.) National income figures for China are based upon extremely nebulous information, but a few intrepid economists have made estimates which vary from US\$12 billion to US\$15 billion. The present budget, therefore, may be equal to between one-third and one-half the figure for national income. In view of this situation, the Chinese Communists are forced to use all possible methods to maximize revenue and to keep budget deficits to a minimum. The Five Anti Campaign was their answer in 1952.

The Chinese Communists are probably worried, however, about the future. Since their rise to power they have tapped most of China's accumulated savings and fluid capital resources, and there is not much left to draw upon. At first they depended heavily upon the accumulated grain holdings of rural China (estimated by some Chinese economists to be one of the main forms of savings and wealth in China before the Communists came to power), but these have now been siphoned off through confiscation and taxation. Then they turned to the cities, and with their successive campaigns they have now squeezed most of the savings and fluid capital from the urban economy. Some Chinese businessmen who have come to Hong Kong from the mainland believe that perhaps the Communists can put on the squeeze once more, and obtain the last hidden savings and capital of the business class, but that thereafter there will be nothing to squeeze. In short, by a process one can describe either as confiscation or as discriminatory taxation the Chinese Communists have taken over most of the private savings and capital in China, and in the future they will have to depend for tax revenue upon the slice they can obtain from current production. This will mean higher tax rates, which may create serious problems even in a country controlled to the degree China is today.

Revenue was not the sole financial aim of the Five Anti Campaign; control of inflation was important too. The Chinese Communists fully recognize the threat of inflation; they realize that it was one of the principal factors undermining the regime of their predecessors, the Nationalists. Their efforts to suppress price rises have not been completely successful - for example, the wholesale commodity price index in Shanghai rose by 17.39 per cent January, 1950, and February, 1952 - but they have gone all out in their attempt to control inflation and in general prices have been kept under control by drastic deflationary tactics. On the one hand they have tried to sponge up paper money, and decrease purchasing power, in every possible way. The Five Anti Campaign, together with regular taxation, accomplished this quite successfully. On the other hand they have reduced the rate of monetary circulation to a slow crawl. Severe punishment for speculation, sterilization of bank savings, and similar methods attempt to accomplish this on a continuing basis, but the Five Anti Campaign made a large contribution on this score too. Commerce almost stopped. Persons who had capital, furthermore, were afraid to use it. And direct government control of prices and indirect control through state buying and selling were greatly increased during the Five Anti Campaign, in ways I will describe in my next newsletter. Consequently, the Chinese Communists have been able to keep the lid on prices despite budget deficits.

During the Five Anti Campaign, the government was not only able to prevent price rises; it actually brought about a drop in the prices of many commodities. In April, at the height of the campaign, state-operated consumer goods stores lowered prices on 10,000 goods in Shanghai, 4,000 in Peking, 3,000 in Wuhan and the Central South, 900 in the Northwest, and 600 in the Northeast. The average reduction in these prices was eight per cent, and some of the commodities dropped in price as much as 40 per cent. The lowering of these prices brought the general price level down, because private enterprises had to follow the trend in government-established prices.

Improvement of the tax collection system was another important financial result of the Five Anti Campaign, and it was not without significance that collection of the 1952 business income tax came at the peak of the campaign, when businessmen were terrorized and were more concerned about their safety than their money. Furthermore, by giving a clear indication that tax evasion was futile because the government would catch up with the offenders in the end, the campaign undoubtedly did a good deal to undermine the traditional Chinese propensity for tax evasion. The Communists, despite the institution of increasingly strict controls during the past two and a half years, have not been immune from the effects of long-standing Chinese traditions. They state, for example, that from 1949 through 1951 they exposed 155,856 cases of tax evasion in Shanghai alone, and if they discovered that many there were probably more. As a result of the Five Anti Campaign, however, there will probably be fewer attempts at evasion in the future; there is not much point in evading taxes if the government is likely to make you confess, and pay up, a year or two later.

The Five Anti Campaign also enabled the government to increase its control over the foreign exchange resources of China, both at home and abroad. Many Chinese merchants and industrialists - as well as ordinary citizens who converted their savings to hard currencies - were able to conceal part of their holdings up until the beginning of this year, but under the psychological strain of the Five Anti Campaign they broke down and their holdings were flushed out. In the cases of many large holders, the exchange was frozen in accounts in the U.S., but the government got its hands on exchange in many other places. Many branch firms in Hong Kong received requests to transfer funds, and although some refused, others paid up. "Cheating the government" of foreign exchange was considered to be a serious offense, and the penalties imposed were often high.

It is not possible to obtain an accurate estimate of the total foreign exchange which the government in China brought under its control as a result of the Five Anti Campaign, but it was undoubtedly a large amount for a country chronically short of foreign exchange.

All of these financial results of the Five Anti Campaign - particularly the revenue obtained for the government - have been extremely important to the fiscal position of the Chinese Communist regime in 1952. In a sense, however, the Five Anti Campaign has been one of the last phases of a period in which the regime has been able to support itself, at least partially, on the accumulated fat of the Chinese economy. This period is now approaching an end. The hidden savings of both the rural and urban economy appear to have been, for the most part, taken in and used up by the government. There may be, as some people believe, a thin layer of fat still remaining, but that will be gone in another campaign or two. Then the government will be financially dependent on taxation imposed upon current agricultural and private industrial production, apart from profits extracted from the socialized sectors of the economy, to balance the largest national budgets and support the largest non-productive government payrolls in the history of China. And there will no longer be any significant special groups in the country able to bear a disproportionate share of the financial burden, as has been the case during the period since the Communists' rise to power.

Sincerely yours,

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