China's economic chaos

Richard Katz goes beyond Premier Zhao's admissions to examine the scope of the new anti-industry policy.

While the U.S. Commerce Department and other public relations agencies still issue enthusiastic projections of China's trade and economic prospects, China's own press is reporting that country's economic straits in the most alarming terms. A landmark Dec. 2 editorial in the official Communist Party newspaper, *People's Daily*, reported the following:

"This year has been a disastrous one for agriculture due to floods in the south and drought in the north, and grain production will be lower than last year." Later reports forecast the decline at 5 percent, from a level that was already no higher per capita than that of 1958. Due to the lower grain shipments to the cities, the government has already announced the cancellation of year-end wage bonuses in 1980.

"An imbalance has appeared between energy production and usage," the editorial continued, "and the imbalance is worse than was originally estimated. There are difficulties facing both the petroleum and coal industries in their attempts to increase production next year." In a recent secret speech getting limited circulation among party leaders, new Premier Zhao Ziyang revealed that oil production will actually fall—from this year's 2.1 million barrels per day to only 2.0 million in 1981 and only 1.9 million in 1982. Coal will also fall. He said the situation may not improve until 1985.

China has been forced to renege on contracts with Japan for export of oil—the commodity it had expected to become its biggest foreign-exchange earner. This in turn has led to cancellation of imports of plant and equipment. Internally, factories are being ordered to increase production without increasing energy consumption, either through "conservation" or switching to non-energy-intensive light industry product lines.

What is the regime's response to this crisis? "We must not hesitate in making a necessary and adequate retreat," the editorial continued. "The amount invested for capital construction this year has already been reduced, but it still far surpasses what the country is at present capable of handling." The national budget for capital investment was cut by 33 percent; the editorial, however, accuses various provinces of taking advantage of decentralization in order to invest in local industrial projects. It demands a halt; "Even projects already built must be closed, suspended, merged or changed in accordance with conditions in all sectors. Otherwise, we cannot curtail capital construction as a whole." Every day the Chinese press reports on projects being halted in mid-construction. According to Premier Zhao's speech, construction will be cut another 40 percent in 1981.

One reason for the cutback is that major bottlenecks in energy and transport make it impossible to operate plants already built. For example, China deliberately cut back on steel production this year by 5 percent, because more than 20 tons—the equivalent of 60 percent of a year's production—lay uselessly stockpiled, because of transport bottlenecks or overproduction of basic cheap products and underproduction of needed specialized products, or because product quality was so shoddy as to be unmarketable. The steel example is typical. A Nov. 19 *People's Daily* editorial complained, "There have been grave difficulties in getting money and materials for projects urgently needed for the improvement of people's lives."

Zhao told visiting Rumanian Premier Ilei Verdet that energy and other bottlenecks forced plants to operate at only 70 percent of capacity, and that many factories will simply be shut down in 1981. Zhao said that under the circumstances, it was even impossible to draw up a budget for 1981. Unless there are "fundamental changes," he said, the crisis will continue at least through 1985.

Chinese official Wu Zhenkun summed up the situation in a Nov. 19 speech in Peking: "We must admit that *over the past 20 years or so, the people's livelihood has not been improved—and the livelihood of some has in fact deteriorated.*" Now Zhao says there will be no wage increase for another five years. What an amazing indictment of the course of Chinese economic policy since the end of Sino-Soviet economic cooperation in 1960!

Deng's longterm readjustment

Vice Premier Deng Xiaoping insists that China is simply going through a necessary "readjustment" from the economic dislocations caused by the Cultural Revolution, but even more so from the grandiose "overambitious" rapid industrialization plans of soon-to-be-ousted Party Chairman Hua Guofeng.

American promoters of Sino-U.S. trade explain it in the same terms. Among these is Arne de Keijzer of De Keijzer Associates, a consultant to both China and American firms on Sino-U.S. trade matters. De Keijzer told *EIR*, "China realized it had to walk before it could run. They have to slow down, go step by step. They thought they could go with agriculture and heavy industry. But now they realize they've got to have a light industry base before they can complete the heavy industry. They have to do it more slowly than they anticipated."

In fact, Deng's policies represent not so much a slowing down of industrialization as an abandonment of any realistic prospect of achieving it. A look at the Hua era shows some of the problems involved and the irony that, on fundamentals, Hua, Deng and the Gang of Four all agree.

Following the death of Mao Tse-tung and the arrest of the Gang of Four in 1976, Hua announced a manic leap into rapid industrialization in many ways reminiscent of Mao's own disastrous Great Leap Forward of 1958-60. The intent was to reverse the 10 wasted years of the Cultural Revolution. Hua announced a $600 billion investment program through the year 2000, lined up $23 billion worth of foreign credit lines, and outlined hundreds of major projects—now mostly scrapped—for steel, oil, machine-building, transport, power generation, chemicals and other areas.

In fact, such a program, properly planned, managed and combined with an influx of foreign technicians and advisers would be the one thing that could save China.

However, decades of Maoist ideology and the destruction of the educated elite during the Cultural Revolution doomed Hua's program. China has simply been unable to develop basic middle managements and skilled labor to implement such a program.

For example, to earn the foreign exchange for the necessary import of foreign technology, Hua demanded that the major oil field at Daqing be pushed to increase output much faster than was technically prudent. The result is that the fields were ruined and have started declining in output long before they would have reached their natural peak with proper management.

China bought a fancy offshore oil rig from Japan, and then lost it when bureaucrats insisted on towing it to sea despite reports of an impending storm; later reports revealed the Chinese had never bothered to translate the Japanese operating and safety manual. China also contracted a $6 billion, six-million-ton capacity steel plant to be built at Baoshan—but located it on swampy ground unable to support the facility. In any case, poor internal transport would have required China to import iron ore from Australia for the plant despite China's own abundant reserves of iron ore. The second phase of this project has now been abandoned.

A *People's Daily* article on a foreign joint venture yarn plant in Guangdong which failed reveals the kind of mismanagement problems that pervade Chinese factories: "The management level of the leading members was too low and the workers lacked specialized knowledge." Packs of raw materials that should have been added in the wool mixing were simply forgotten. Some machines were "badly damaged due to lack of maintenance and repair and improper handling." Only 40 percent of the factory lights worked, "but for a long time nobody took any notice."

Beyond the systematic disregard of the most elementary realities at the microeconomic level of management lies a more fundamental problem in the economic/social policy shared by virtually all factions in China. This policy mandates that as a matter of deliberate policy the 80 percent peasant-to-urban demographic ratio will not be reduced. As a result, much of the supposed industry in the country amounts simply to ancillary items for rural communes.

One-third of all coal mining, for example, takes place manually in pits of less than 10,000 tons per year and is unusable in modern furnaces; one-third of all steel is produced in scattered mills on rural communes; one-third of all hydroelectric power is produced in primitive rural generators of 25-50 kilowatt capacity, about the amount needed to run an apartment building; one-third of all industrial labor is in the communes, not in cities.

The result, of course, is tremendous inefficiencies. It takes two to three times the amount of energy and coking coal to produce one ton of steel in China as in the West. Small Chinese generators are one-third as thermally efficient. Some of these problems are simply the result of backwardness. For example, since it takes decades to build a national electricity grid in such a big, backward country, it makes sense *temporarily* to have small power plants to run irrigation pumps, etc.

The problem is that in China all the factions have enshrined such a necessary evil as a shining virtue—just as the World Bank is trying to do in other countries, often using China as a model. The result is that China is not only unable to develop industry but remains unable to get off the treadmill of simply keeping grain production level with population—and even that capacity may now be in doubt.

Hua tried to industrialize sectors of the economy, particularly those serving as a base for the military, while maintaining the agrarian bias. Admittedly, Hua's program was woefully misconceived and mismanaged from the start. After an initial *claimed* spurt of 10-12 percent production growth rates in 1977-78, Hua's mini-Great Leap collapsed. Deng, however, is compounding

A wicker caravan in New York

The first thing a visitor to the Dec. 6-28 China Trade Exhibition in New York saw was a mini-Great Wall adorned with Chinese flags planted firmly in the middle of Columbus Circle. The Chinese announced their arrival in New York for three weeks to show their nation's produce with a big splash. Hundreds of thousands of New Yorkers, like Chicagoans and San Franciscans before them, flocked to the fair. Some thousands of them are buyers for American firms.

The exhibition itself begins with the arts and crafts display, ranging from museum pieces to brush paintings of flowers that attracted small storekeepers. The arts and crafts drew most of the spectators, and also the largest group of buyers, some 26 percent. Indeed, Chinese Foreign Trade Ministry official Chen Kechang told *EIR* that this is what China expects to sell most—handicrafts, wicker baskets, bamboo items. Chen explained that few sales were made at the fair itself. "In this regard it is not quite successful," because the buyers did not know China's products yet.

Passing from the arts and crafts into the garment section, silk blouses in the 50-dollar range were most on display. Few mass-produced clothes or even textiles could be found. Chen explained that synthetic textiles or garments are out. "We cannot compete with Korea or Taiwan since our raw materials are so expensive." Asked if China has the wherewithal to ship cotton goods, since its own cotton production has stagnated since 1972 and its domestic demand is rising, he replied, "It's hard to say. We have one billion people—a lot of people. They want more."

The reaction of the textile buyers, the second largest group, numbering 22 percent of the visitors, was mixed. Some said they would buy garments, others expressed dismay at the lack of "gray goods" textiles for display, and still others thought they could get better quality at cheaper prices from Korea, Hong Kong, or Taiwan.

Chen said he discovered that the real market for China in the U.S. is the bargain-basement stratum. "We thought we had to bring all our best-quality goods. But we learned that, in many cases, price is the main consideration, for example, in paint brushes." Indeed, Gary Furst of the American Brush Company told *EIR*, "I came here looking for cheap stuff. The products here were of better quality than I expected, but priced too high." Chen also suggested that cheap, throwaway beach thongs could become an American boom item.

The real selling at the fair was not done bv the Chinese, who made little in immediate sales, but by the "Bloomingdale's People's Market." This department store for New York's "beautiful people," which has consistently promoted U.S. ties with Peking, took over a whole floor of the exhibit. They sold polyester shirts, of the type usually available for about $7, for $16; they hawked woolen rugs and silk blouses, revolutionary posters and porcelain Buddhas and bamboo hats.

One of the most interesting exhibits, though little visited by either spectators or buyers, was the display of Chinese machine tools. The lathes, borers, and so forth ranged from Soviet-designed models to more up-to-date automated designs. They were nothing spectacular, but could conceivably fill a gap in the lower-level tools no longer made in the United States, should quality and price prove to be competitive with Korea or Taiwan. Clearly this was the best China had to offer, in contrast to the more typical models at home that receive so many complaints of poor workmanship.

More interesting than the machines themselves were the technicians accompanying them. At least some of them represented a side of China that shows why Deng Xiaoping will have a tough time fully enforcing his abandonment of heavy industry. The technicians were clearly proud of their machines. Naturally, they had been educated prior to the Cultural Revolution.

One had even been a Red Guard. "But by 1967, everybody knew it was wrong. People were being killed, my friends were sent to the countryside." Asked why Mao is not posthumously on trial with his widow Jiang Qing, he replied, "Without Mao, China could not have become independent. No matter what he did later, this cannot be taken away. But it is true that without him, the Gang of Four and the Cultural Revolution could not have happened." At the point that he and millions of Chinese like him understand that Deng's wicker-basket economics is not so different from Jiang Qing's, Bloomingdale's may have to look for new suppliers.

the crisis: since Hua proved unable to implement a heavy-industry program, Deng has proposed abandoning the goal of heavy industry in favor of a get-rich-quick light industry approach.

Deng's strategy is modeled directly on the ideas of Soviet politician Nikolai Bukharin, who in the 1920s and 1930s counterposed a light-industry approach to Lenin and Stalin's heavy industry policy. The ironies go even further: Bukharin learned his economics in Vienna, sharing classes with Milton Friedman's mentor Friederich von Hayek. Deng in turn—perhaps after seeing how Volcker has destroyed U.S. heavy industry by using Milton Friedman's ideas—invited Friedman to lecture in China earlier this year.

In reality, Deng's attacks on heavy industry have produced a capital and materials shortage that is now cascading out of control, as Premier Zhao has now admitted. Some Chinese publications claimed an estimated 12 percent industrial growth over 1979 levels during the first half of 1980 based on the quick returns from light industry. Premier Zhao's secret report now projects an 8 percent year-to-year growth for all of 1980—implying a drastic reduction in growth towards the end of the year. All such quantitative estimates are extremely rough and unreliable at this point, but the downward trend is clear. It is likely that the industrial growth will go to a very low level, and could turn negative.

The Chinese press reports widespread opposition to Deng's program both among the military and "heavy industry" civilian factions, whom Deng is now purging. These include Gu Mu, who resigned as head of the state capital construction commission but retained his job as including the ouster of Party Chairman Hua Guofeng, state energy commission, and Kang Shien, minister of petroleum. While Deng may temporarily have the upper hand, the problems raised by his economic policies mean that internal fighting over economic policy will continue, particularly if the expected decline in living standards resulting from Deng's policies leads to outbreaks of peasant and urban unrest.

Fighting to maintain stability

The number-one priority for the Deng Xiaoping regime is to prevent this economic turmoil from spilling over into political unrest. Deng vividly remembers the widespread illegal strikes and even riots that embroiled China in 1976 because the economic disruption caused by Jiang Qing's "Gang of Four" led to drops in living standards. One of Deng's first moves as he consolidated power in 1978 was to institute material incentives at the workplace and to declare the first general wage increase in 20 years. However, since China was not producing the consumer goods to absorb the wage increase, the increased wages simply fueled price increases, now yielding a stubborn 7-10 percent inflation rate. The combination of the price increases and the cancellation of year-end bonuses following the grain and energy decline has already led to the first economically caused internal unrest since 1976. Workers in Chang-sha, the capital of Hunan province, held a demonstration against price increases in late December. Farmers in various provinces have also protested.

With Deng launching a wholesale grab for power, including the ouster of Party Chairman Hua Guofeng, a purge of the army, and a denigration of the memory of Mao, he can ill afford any restiveness among the population.

Deng tried to grant immediate consumer concessions at the expense of investment. The cancellation of year-end bonuses and Zhao's prohibition of wage increases shows how limited is the ability to implement this approach, but under the rubrics of "readjustment" and "switching from heavy industry to light industry," Deng attempted to buy off the population.

For example, even while cutting back on $3 billion worth of plant orders from Japan for steel, chemical and refrigerator factories, Deng's regime imported 300,000 black and white televisions, 130,000 tape cassette players and 400,000 wristwatches from Japan. Internally, investment priorities, materials allocations, etc. are being shifted from heavy industry projects that require several years to pay back the investment to light-industry consumer-goods areas such as textiles, garments, bicycles, radios and other items that require little investment, little energy and provide quick returns.

Trade Ministry official Chen Kechang explained to *EIR*: "We have to produce light-industry products that yield a return in a short time so people can see results. We have to manufacture light-industry products for the people's daily life. Heavy industry such as steel and chemicals takes too much capital and too much time to show results."

In part the "readjustment of light industry" is due to Deng's long-term light-industry perspective for the economy. However, the situation is out of control. The Dec. 2 editorial said that originally the readjustment program was to have been completed in 1981—now, they say, it will take until the end of 1983. Chen Kechang told *EIR*, "It will take even longer, four to five years."

In the haste to provide concessions to the population despite the declines in grain and energy, the "readjustment" program is being carried out almost without regard to the future. A report on the city of Tianjin (Tientsin) states that in the last two years "the municipality has cancelled and postponed 74 local construction projects. Most of the projects cancelled and postponed are productive."

Half of the $250 million saved in this manner was

One-third of China's steel is produced in tiny commune furnaces like this one.

shifted to housing construction, "guaranteeing the satisfaction of the needs in housing and urban construction projects while there is a shortage of construction forces and building materials." As to where the building materials will come from in following years if there is little investment in heavy industry now, the report says little except to complain of "inadequate curtailment of productive projects."

Some of the "readjustment" measures are being carried out with such franticness as to practically guarantee a future *decline* of living standards. For example, a Dec. 18 report from one of China' most productive farming provinces, Heilongjiang, mandates that "the water conservancy capital construction front should be cut back and the number of irrigation projects should be reduced."

Yet the only way China managed to keep grain output growing as fast as population was to construct widespread flood control and irrigation projects allowing double and triple cropping as well as expansion of cultivable acreage. There were already serious problems with China's farm policy over the past 20 years—particularly a neglect of mechanization and chemical fertilizers that made it impossible for China to increase per capita grain output while leaving China vulnerable to flood and drought. This new cutback for the sake of immediate results adds a new nightmare.

"Costly large and medium-size [water] projects begun a couple of years ago which will not yield results in the *near* future . . . should be stopped. Projects under construction requiring less investment which will be completed *next* year should not be stopped. Annual expenditures should be reduced. No large or medium-sized water conservancy projects should be initiated *in the next five years* [emphasis added]." In the next breath, the report adds that "the conference urged all localities to do a good job in preventing spring waterlogging and droughts."

Trade cutback

The same meat-axe approach has hit the trade sector as well. After months of cutbacks in import of steel and chemicals, in November China suddenly announced unilateral abrogation of a number of contracts with its number one trade partner, Japan, for plant imports. This included cancellation of a $3 billion second phase of the massive Baoshan steel project, $400 million worth of chemical plants, and a $20 million refrigerator plant. On the other hand, the grain crisis at home and the need to grant concessions to workers increased imports of grain and wristwatches.

Part of the reason for the cutbacks is a foreign exchange crisis. The decline in oil production has delayed at least until 1987, in latest Chinese estimates, the growth of what China had hoped would be its biggest foreign-exchange earner. China has already reneged on contracted oil deliveries to Japan. The oil shortage also precludes making synthetic textiles and garments a major export. Simultaneously, the absolute stagnation in cotton production since 1972 combined with import quotas in the U.S. and Europe limits rapid growth in natural textiles and garments.

While China's two-way trade enjoyed a five-fold increase from 1972's $6 billion to 1979's $30 billion, including a 30 percent increase in 1979 alone, rough estimates for 1980 growth are only 7 to 10 percent (mainly due to oil price increases) and China's announced plan for 1981, which may not be met, is only 7 percent growth.

The foreign exchange shortage is only part of the reason for the import cutback. Perhaps more important are serious doubts about China's ability to use the plants once imported or even to physically get rapidly increased amounts of imports into the country. De Keijzer told *EIR*, "China really can't handle much more business immediately. . . . I don't think they have the management or infrastructure. Look at China's ports. Even if the Chinese built the container loaders which they need so they can export more efficiently, there's no way you're going to get the goods into port in the first place. The inter-modal transport is still very complex. It's like delivering it in a boxcar and taking it out in a bicycle. The internal transport system to get it to Shanghai is still very difficult."

Some of the plant imports being cancelled would have produced petrochemicals or other items for future export. Why then did China cut back on future foreign exchange earners in order to save now? The Chinese press reveals that raw materials bottlenecks plus quality problems in output were as much a consideration as foreign-exchange shortages. Premier Zhao Ziayng revealed two weeks ago that more than $2 billion in imported goods is lying around idle for lack of ability to use them.

China's press has begun a campaign against use of foreign and advanced technology except in limited areas, as shown in a Dec. 8 *People's Daily* editorial. "The higher the degree of mechanization and automation of enterprises, the stricter the demand on the types, specification and quality of raw materials. Some imported projects not only require a great deal of capital and foreign exchange during construction, but after they have started operation, they must still also rely on imported raw materials. . . . Furthermore, the more advanced the technology adopted, the less manpower the unit making the investment will employ, which will give rise to serious contradictions between labor productivity and full employment."

The Dengists are instead proclaiming the virtues of labor-intensive production both for domestic output and for export. "At present, for one million yuan's worth of fixed assets, 94 people are employed in heavy industry, 257 in light and textiles industries, and 800-1000 in the arts and crafts enterprises . . . and arts and crafts and other labor-intensive trades consume only a fraction of the energy and raw materials compared to heavy industry. . . . Plans are being drawn up to develop and export labor-intensive products." Exports of such products increased 23 percent in 1980, according to the Chinese press, but as De Keijzer noted, "you have to sell a lot of wicker baskets to buy one oil well." More importantly, only imports of foreign technology—though certainly in a balanced, rational manner—can end the bottlenecks in energy, transport, machine-building, metallurgy, chemicals, etc. without whose solution China cannot develop either agriculture or industry. By limiting its imports of foreign technology to such resource extraction areas as offshore oil wells and concentrating on labor-intensive production and export, the Dengists are throwing away China's future.

Deng's major gambit for the introduction of foreign technology is the creation of special zones on the coast for foreign investment, on the basis of joint ventures and compensation trade agreements for labor-intensive products. China has set up 300 such agreements so far in Canton's Guangdong Province in which foreign firms build factories and often bring in the raw material in exchange for a set amount of product. One of the most successful of such ventures was run by Japan's C. Itoh for a trouser factory outside Peking. In this case, C. Itoh provided the materials, dealing with a problem which, says *Asian Business* magazine, "is rapidly becoming more acute—the shortage of high-grade fabrics and other raw materials needed to produce the garments demanded on the world market."

Many of the compensation trade agreement ventures are not so successful. One pioneering case in Guangdong province had to be shut down because management and labor produced goods too shoddy to sell. Construction projects to create a large foreign investment zone in the Shekou area of Guangdong had to be shut down due to mismanagement and corruption.

A more serious political problem also rears its head. If the rest of the economy collapses while the only growing section is export-oriented labor-intensive special zones that don't ignite general industrialization—the Hong Kong model—then some Chinese may wonder whether these zones are just a bit too reminiscent of British colonial zones in pre-1949 China. Deng may have the upper hand for now, but the collapse of his economy portends future political trouble for his faction.