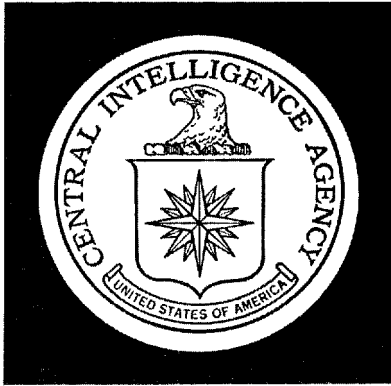


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Special Report

Communist China's Economy Continues to Deteriorate

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COMMUNIST CHINA'S ECONOMY CONTINUES TO DETERIORATE

Over the past two years, the Cultural Revolution has caused considerable damage to every sector of the Chinese Communist economy except agriculture, and further difficulties are likely in 1968. An above-average grain harvest in 1967 masked the effects of much of the economic loss last year, but the harvest was a windfall attributable entirely to excellent weather that almost certainly will not be repeated this year. The internal disorders were also responsible for a modest decline in foreign trade last year, and trade in 1968 is expected to show a more pronounced drop. The leadership in Peking continues to be preoccupied with political problems and internecine disputes rather than with the serious efforts necessary to reinvigorate the economy.

No Easy Path to Economic Recovery

Peking's procrastination over the strong measures needed to revive the economy has not been a result of its ignorance of the necessity. The moderates under Premier Chou En-lai, at least, have been alert to malaise in the economy from the time of the earliest Cultural Revolution disorders. It was presumably their watchfulness and influence that led to the curbing in 1967 of political excesses that had caused dangerous economic disruptions.

The current period of relative calm has lasted six months, suggesting that the leadership as a whole may finally have accepted the lesson of repeated experience that prolonged turmoil is not compatible with economic viability. Willingness to maintain curbs on excesses, however,

does not rectify damage already done to the economy.

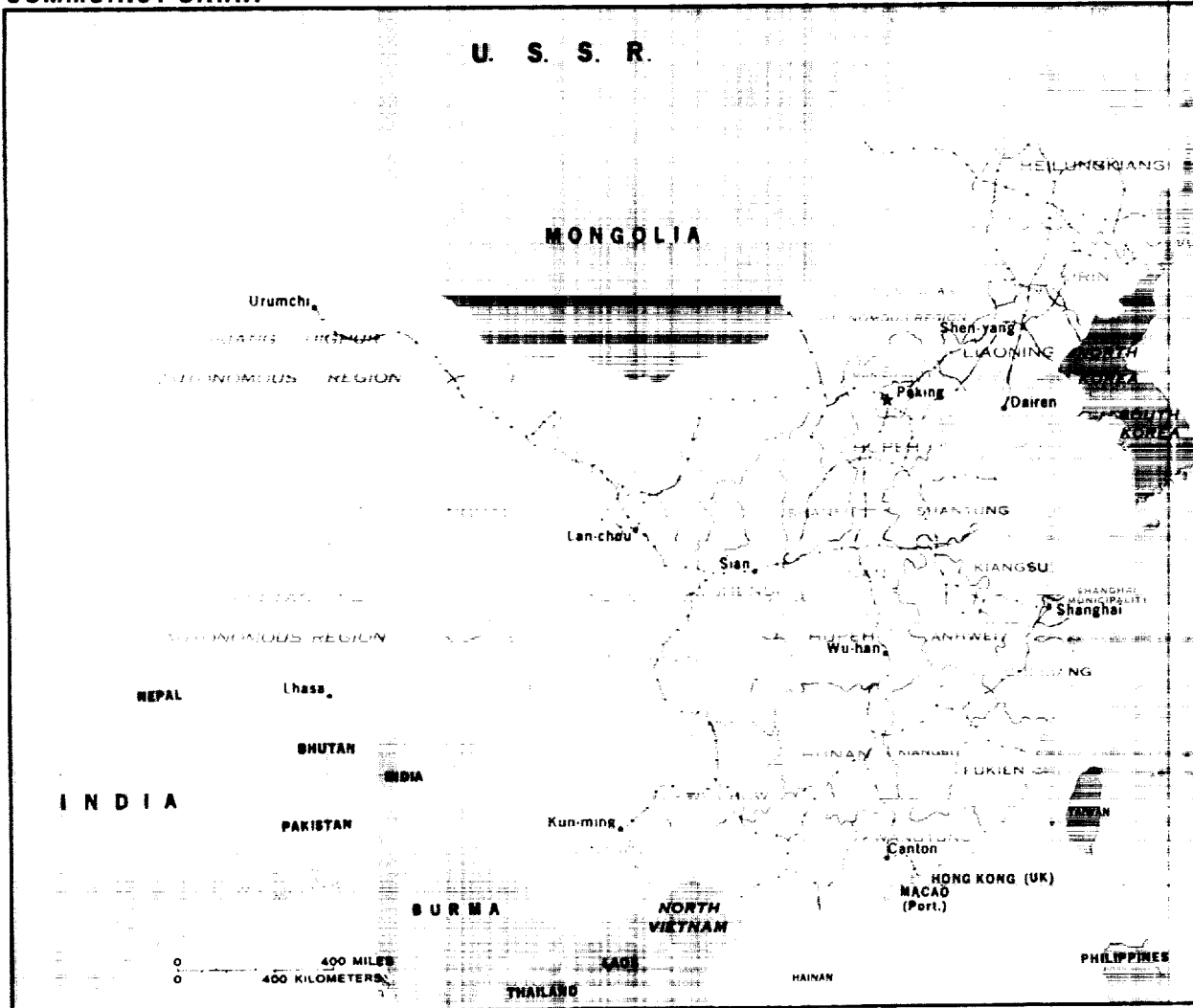
Restoration of orderly economic work in a Communist state is dependent on re-establishing discipline over the population. During the course of the Cultural Revolution, the party cadres running day-to-day economic affairs lost their authority and effectiveness. With no one exercising firm control, workers neglected their work and factory environments became so disrupted that orderly production was difficult or impossible. Peasants, also under looser restraint, used their new leeway to demand a larger share of the harvests and to give increased attention to private plots and marketing activities.

So far, the regime has attempted to regain control over the population through a soft approach. The press and

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high officials have employed reason and persuasion to herd workers and Red Guards back to their posts or home areas. Where the risk of provoking defiance has not been too great, economic sanctions such as cutoffs of salaries and abolition of free rail tickets have been applied.

The regime probably considered stronger measures impractical, if only because the administrative means to impose controls are lacking. Many party cadres are apparently still refusing to resume their posts despite virtual pleas from Peking. In any case, they could not easily exact the former obedience from the population. Moreover, although army units are present in most of the important economic areas, they do not have the numbers or the competence to substitute for party cadres in the exercise of professional and disciplinary control over the population.

Food and Agricultural Prospects

The Chinese have survived the winter without a food crisis despite difficulties in the procurement and transport of the autumn 1967 harvest. Food prospects for the current year, however, are not as bright as a year ago.

The 1967 grain harvest, boosted by exceptionally good weather, approached 200 million tons, or about 10 million tons more than 1966. It is apparent, however, that the increase was mostly dissipated to tide China over a year of turmoil and that not much surplus was left for 1968.

Disorders affecting the countryside--although mild compared with urban disorders--permitted peasants to divert much of the 1967 gain in grain output to increased personal consumption. In addition, population increases absorbed another 4 million tons and an additional million or so tons went to compensate for a decrease in grain im- 25X1
ports.

Even with the very good national harvest, some regions barely managed to get along over the winter.

in north China provinces, which historically require supplementary food 25X1
from the outside [redacted] grain rations during March and April included corn and other "coarse" grains. As had been indicated in the press since autumn 1967, the regime presumably had been forced by impaired ability to procure and distribute food to cut back drastically on im-25X1
ports from other provinces.

[redacted] many of the isolated localities that had poor harvests in 1967 were left mostly to their own devices by the government. Food bureaus, [redacted] 25X1
[redacted] frequently 25X1
had no food to distribute or to sell, even at high prices.

In a speech on 2 February to representatives of various economic ministries, Chou En-lai took a sober view of crop prospects for 1968. He said that supplies of chemical fertilizer and other industrial commodities that support agriculture will decline further in 1968. Moreover, he alluded to the failure of the Ministry of Agriculture to provide leadership over farm work during the past two

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years, and did not offer any hope of an improvement in leadership this year.

Without improved controls and with declining industrial support, the 1968 crops would need better weather than 1967--an extremely unlikely occurrence--simply to match 1967's output.

If an exceptional performance is made in any part of the agricultural sector, it will probably be on the private plots. The government, however, would find it particularly difficult to estimate the size of or to collect from private plot output, and gains would probably go mostly to increased peasant consumption and to boosting supplies for the free market.

Industry Hurt Most by Cultural Revolution

Chinese industrial workers, despite their preferred status in a Communist society, have apparently accumulated serious grievances. Vociferous demands during the past year for higher wages, more benefits, and changed hiring practices have forced the government to promise concessions "when the Cultural Revolution is completed." So far, however, the demands have been put off, and continued worker dissatisfactions, coupled with the presence of trouble-making Red Guards in factories, have sustained a moderate level of disorder.

A precise estimate of industrial losses in 1967 is not possible, but total industrial output probably fell at least 10

percent compared with 1966. Declines of 10 to 20 percent hit the coal, cotton textile, and iron and steel industries. Also lost was the 5 percent or so increase in over-all output that would probably have come without the Cultural Revolution.

Small plants producing simple industrial products and consumer goods suffered the largest declines, and some were totally shut down for substantial periods. Without any protection from the government, the small plants fell prey to every civil disturbance and were the first to be affected when shortages of fuel, raw materials, and electric power developed.

The defense industries also have been substantially disrupted. In an address on 17 January 1968 to representatives of the defense production ministries, Chou En-lai rhetorically asked, "How many of the production targets did you fulfill last year? You know full well." He complained that the three-sided alliances of army, party cadres, and Red Guards--the main device for suppressing contention in factories--had been formed only in the Sixth Ministry of Machine Building, which is engaged in shipbuilding. Steps toward alliances had been begun but were not yet completed in the ministries responsible for land armaments, aircraft, and electronics. No steps, Chou said, had yet been taken in the Seventh Ministry of Machine Building, which performs missile work.

The impact of industrial losses in 1967 has so far not been great, but it may be compounded in coming months. The consumer-goods

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shortages that developed in many of the large cities were of little consequence to the government and did not change conditions very much for the average Chinese, particularly not for the peasant. Shortages of fuel caused some hardship to civilians in the north where winter heating is required, curtailed many industrial operations, and affected fulfillment of export commitments in small ways.

Wage costs to the government appear almost certain to rise. The official promises of "reforms" and "adjustments" refer to many practices increasingly used in recent years to reduce the national wage bill at the expense of the workers. Intense worker dissatisfaction seems to have been stimulated by piecework and time-rate payments, by temporary and contract hirings, and by the firing of old workers on the verge of retirement eligibility. Unless the regime is prepared to adopt harsh repressive measures, some of these practices will probably have to be at least relaxed, at considerable money cost to the government.

Transport Problems in Hand

There has been a gradual re-establishing of order on the railroads--and presumably on other transport systems as well--since late 1967. Occasional short interruptions still occur because of large-scale disorders, but railroad troubles have generally been reduced to uncertainties over scheduling, some mix-ups in national rail-car distribution, and some restrictions on service.

Currently, the railroads are probably carrying the lightest loads in some time.

[redacted] there is a continuing shortage of fuel and of some industrial products--mostly consumer goods--in large cities. These shortages may be partly a result of persisting transport inadequacies, but declines in output of the goods probably bear most of the blame.

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The railroad organizations themselves appear to be in comparatively good order. According to the press, most if not all of the major railroad bureaus have successfully established "three-sided alliances."

Rail shipments of aid to North Vietnam from and through China are believed to be proceeding without serious hindrance. Even during the most chaotic periods of the Cultural Revolution, these shipments probably were affected only in minor ways.

Foreign Trade Decline

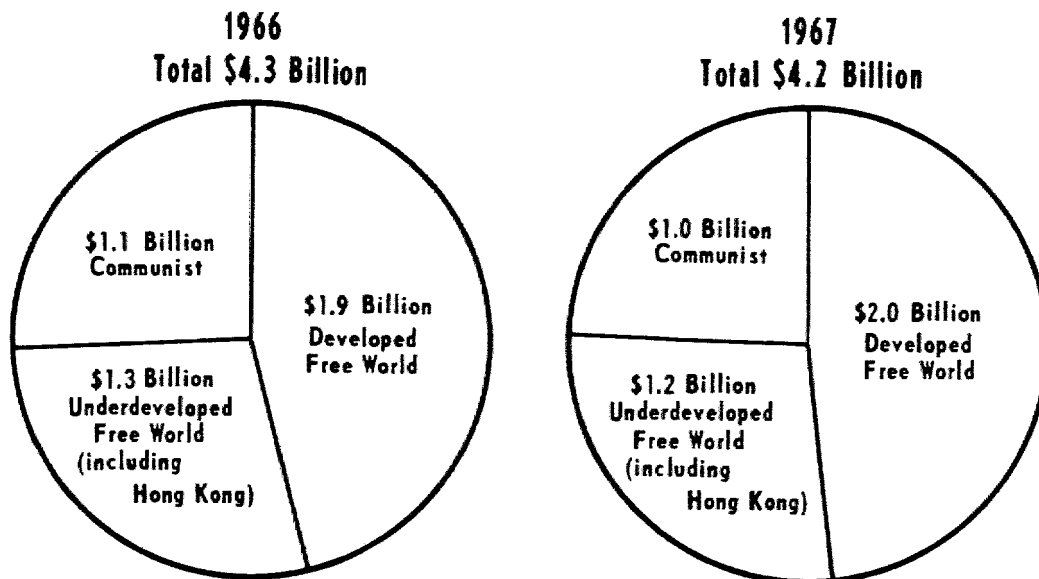
The value of China's foreign trade in 1967 declined for the first time in five years. The balance of payments with the free world showed a \$55-million deficit in contrast to the \$155-million surplus of 1966. Peking apparently was caught between a decline in domestic output of some export goods and a generally undiminished requirement for imports.

The one large decrease possible in imports was grain, where

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Communist China's Foreign Trade



Communist China's Top Ten Trading Partners, 1966-67

	1966		1967 a/	
	Million US \$	Percent of Total All Countries	Million US \$	Percent of Total All Countries
Total Ten Major Countries	2,600	61	2,519	60
Japan	622	14	558	13
Hong Kong b/	380	9	321	8
USSR	320	7	292	7
West Germany	217	5	255	6
Canada	214	5	231	6
Malaysia and Singapore	190	4	228	5
United Kingdom	177	4	201	5
Cuba	170	4	146	3
France	160	4	144	3
North Korea	150	3	143	3
Italy				

a. Preliminary estimates.

b. Net of entrepot trade with third countries.

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\$85 million was saved compared with 1966 by reducing purchases to some 4.7 million tons, about a million tons less. This saving, however, was more than offset by the effects of Peking's spring campaign against the Hong Kong authorities. Trade both ways with Hong Kong fell by about 15 percent to \$340 million, but almost all of this drop comprised Chinese exports.

The value of total Chinese imports during 1967 actually increased by one percent despite the reduction in imports of grain. Steel and chemical fertilizers increased by 22 and 20 percent, respectively, at least partly because of need to supplement sagging domestic output. Chou En-lai has stated that total chemical fertilizer availability in 1967 declined, the increase in imports notwithstanding.

Total Chinese exports in 1967 fell by 6 percent. Textiles declined by about 8 percent even though Peking seems to have made the decision to make domestic consumers absorb the loss in output rather than exports. Exports of foodstuffs declined about 6 percent, perhaps partly because the government found it more difficult than usual to procure the needed foods from the peasants.

At the end of 1967, China still had at least \$600 million in gold and foreign exchange holdings, an amount judged adequate for emergency requirements. Peking was able to muster enough Western currency to buy about \$50 million worth of gold follow-

ing the British devaluation in November 1967, and in addition, was able to conserve some foreign exchange by invoking a time-payment clause for grain from Australia.

Trade with the free world in 1967 declined less than trade with Communist countries, raising its share of total trade to 75 percent. Exports to Western Europe and Japan declined by \$65 million. Imports of several steel mills and petro-chemical plants continued, but their construction was slowed by Red Guard obstructions at the building sites and by political persecution of Western personnel, including the arrest of two West German engineers in Lan-chou for "espionage."

The free world continued to supply imports important to the military-industrial base. A group of Japanese firms used an elaborate scheme to slip equipment piecemeal into China over an 18-month period to complete a silicon plant that enhances China's electronics capability. Imports of free world machine tools tripled in the first half of 1967 over the same period of 1966; imports of electronics equipment, metals, and scientific instruments of importance to the weapons program also increased in 1967.

Trade with Communist countries in 1967 fell by about \$95 million to a new low of about \$1,040 million. During the year, Sino-Soviet relations were further exacerbated by Chinese harassment of Soviet merchant seamen in Dairen and Canton and

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by at least one case of mutual retaliation when, in September, the Soviets banned Chinese pork for "health" reasons and the Chinese refused to accept petroleum and machinery shipments. Trade with Eastern European countries fell slightly in 1967 and only one of the three new trade agreements signed so far calls for increased trade in 1968.

Chinese exports to the developing nations of the free world in 1967 reached about \$540 million, up from \$525 million in 1966. Imports from them, however, dropped more than 25 percent to about \$285 million. Primarily, the drop reflected the absence of grain imports from Argentina. [REDACTED]

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