



Political and Economic Briefing
on the People's Republic of China

for

Secretary of the Interior

Rogers C.B. Morton

18 April 1975

Political and Economic Briefing

on

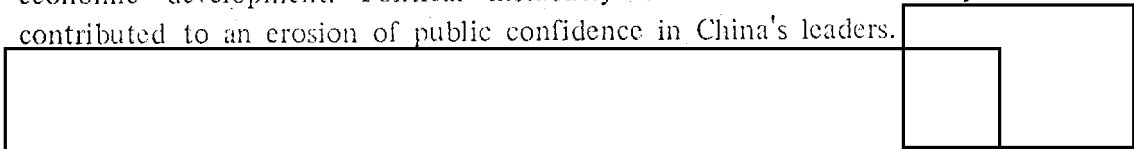
the People's Republic of China

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18 April 1975

I. The Current Political Situation
in the People's Republic of China

Peking in recent months has devoted primary attention to putting its domestic house in order, a precondition for carrying out its stated goal of building a modernized China by the end of the century. Repeated calls for unity and stability suggest that China's leaders are trying to put behind them the personal and political animosities that have plagued the leadership for the past nine years and have slowed economic development. Political instability over the last several years has contributed to an erosion of public confidence in China's leaders.



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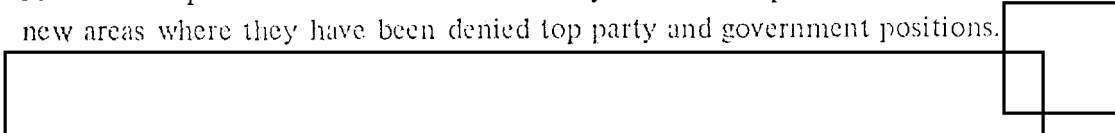
Major party and government meetings held last January emphasized the unity theme and, more importantly, laid the groundwork for a relatively orderly succession to the current aging leadership. China's current leaders are essentially the same group that has ruled the country since the Communists came to power in 1949. As none of these people can be expected to survive for more than 10 years, a priority need is the grooming of younger leaders who are capable of directing China's economic development program for the next 25 years.

The succession question took on greater urgency last summer with the hospitalization of Premier Chou En-lai who is generally regarded as the architect of China's current domestic and foreign policies and the leader of the moderate coalition in the party. Chou remains in a rest home but seems still to be in overall control of affairs of state. The supervision of day-to-day affairs, which was Chou's primary task for more than 20 years, has now been turned over to 70-year-old Teng Hsiao-ping. At the meetings in January, Teng was named first deputy premier and is Chou's apparent successor.

Teng seems to be in general agreement with Chou En-lai's policies and is not expected to make any major changes if and when he becomes premier. Teng has a well-earned reputation as a strict disciplinarian and an able and experienced administrator. At the meetings in January, Teng was named to top positions in the party and the national military hierarchy, thereby giving him important posts in China's three major bureaucracies -- the party, government, and military.

At his age, however, Teng is an interim successor at best. Behind him are several competent officials in their 40s, 50s, and 60s who were also given important jobs last January. The State Council that was appointed in January consists primarily of these and other officials of moderate persuasion. Several are known proteges of Chou.

The extreme left wing of the party, which is headed by Mao's wife, Chiang Ching, was all but excluded from the new government and has lost influence in party affairs as well. The power of the military, which was the dominant political force until a few years ago, has also been sharply reduced. Civilians have been named to several top military posts, and many of the most influential military men in the provinces were transferred away from their power bases and sent to new areas where they have been denied top party and government positions.



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As Peking builds toward the future, the position of China's top leader, Mao Tse-tung, has come increasingly into question. Mao has been out of Peking since last summer, his longest absence from the capital since coming to power. Recently he has stopped meeting foreign visitors, and there are signs that Chinese officials are beginning to take a critical view of many of Mao's former policies. Some people seem to hold Mao responsible for the political instability of recent years. Although Mao is on record as endorsing the unity and stability theme, his physical separation from the rest of China's leaders raises questions about his actual view of current developments. Mao is kept fully informed of all major developments, but the Chairman's prolonged absence from the capital suggests that he may not fully endorse some recent decisions.

II. The Chinese Economy

Premier Chou En-lai in his government work report to the National Peoples Congress last January surveyed the mixed performance of the economy in 1974 and suggested that the leadership expects economic growth to be gradual for some time. Although Chou provided few statistics on either planning or performance, we believe that the Chinese economy grew in 1974 by only 3% -- down from almost 10% in 1973. Growth in industry slowed to 4%, from a respectable 12% in 1973, and agricultural output barely matched the increase in population (about 2%).

Among the factors holding back industrial growth in 1974 were:

- the persistence of imbalances among the extractive, processing, and finishing industries, highlighted by shortages of coal;
- sporadic work stoppages, lowered worker morale, and reduced productivity created by the anti-Confucius campaign; and
- the overburdening of the transportation system, particularly the railroads.

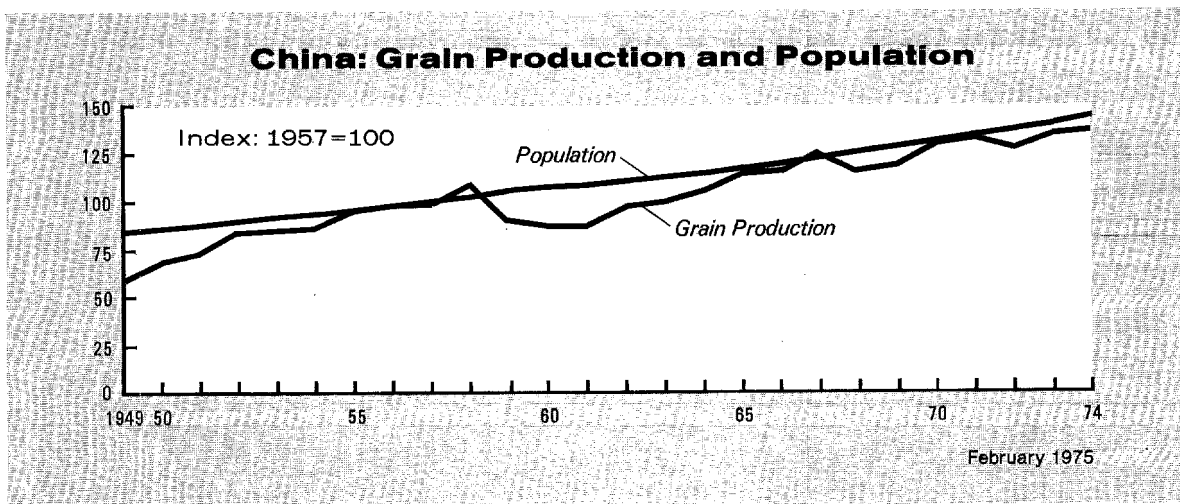
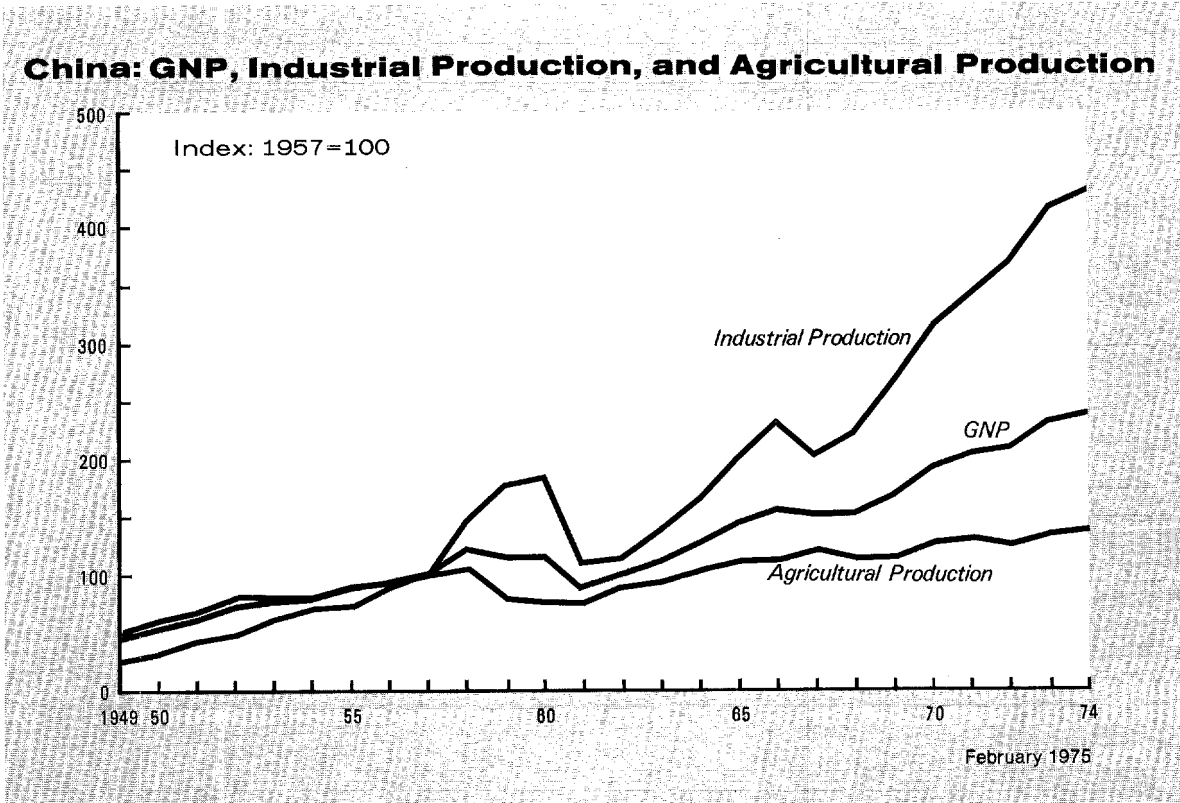
The sharpest decline occurred in steel output, which fell by 6% in 1974 to about 24 million tons. On the positive side, the petroleum industry continued its strong growth, with a 20% increase in crude output to the 65 million ton level during the year, while the production of electric power, tractors, chemical fibers, and cement also showed increases.

Agricultural growth during 1974 was adversely affected by generally unfavorable weather for winter wheat and for fall-harvested grains. Grain output exceeded the 1973 level of 250 million tons, rising to about 255 million tons. Nevertheless, grain production in 1974 was clearly less than the authorities hoped for. Imports of grain, which were 7 million tons in 1974, will continue, with 5.4 million tons already slated for delivery in 1975.

In foreign trade, total exports rose last year, with the rapid expansion of earnings from oil exports more than offsetting the impact of shrinking world markets for traditional Chinese exports. Imports grew even faster as worldwide inflation pushed up China's import costs. China's hard currency trade deficit increased from the 1973 level of \$370 million to perhaps \$1.3 billion in 1974, in part from heavier use of medium-term credits to finance whole plant imports.

Chou reaffirmed the development priorities of agriculture, light industry, and heavy industry which have prevailed since late 1972 and reiterated Chinese interest in expansion of trade relations with the non-Communist world. The reduction of economic ministries and commissions – from 40 to 25 and from 12 to 3, respectively – announced at the NPC and Chou's statement that the PRC is drawing up a ten-year plan in addition to five-year and annual plans suggest that the degree of centralized planning and management of the economy is to increase.

Chou also singled out the period of the Fifth Five-Year Plan (1976-80) as crucial to PRC attainment of economic "front rank" status in the world by the end of the century. The basic problem remains that of lifting the long-term rate of grain production above the rate of population growth. Solution of this problem through expanding industrial inputs to agriculture – including inputs of foreign technology – is clearly implied in Chou's speech. In sum, Chou En-lai appears to have charted a course of carefully planned but slow growth for the economy over the next 15 years. The leadership is in transition and, given the PRC's past experience with radical turns in economic policy, the present moderate approach may be difficult to maintain.



People's Republic of China: Economic Indicators

March 1975

	1952	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
GNP (billion 1973 US \$)	67	94	113	107	106	82	93	103	117	134	145	141	142	157	179	190	197	217	223
Population, mid-year (million persons)	570	641	657	672	685	695	704	716	731	747	763	780	798	817	837	857	878	899	920
Per capita GNP (1973 US \$)	117	147	172	160	155	118	133	144	160	179	190	180	178	192	214	222	225	241	243
Grain (million metric tons)	154	185	200	165	160	160	180	185	195	210	215	230	215	220	240	246	240	250	255
Cotton (million metric tons)	1.3	1.6	1.7	1.2	0.9	0.8	1.0	1.2	1.7	1.9	1.8	1.9	1.8	1.8	2.0	2.2	2.1	2.5	2.5
Industrial production index (1957 = 100)	48	100	145	177	184	108	114	137	163	199	231	202	222	265	313	341	371	416	432
Crude steel (million metric tons)	1.35	5.35	11.1	13.4	18.7	8	8	9	10.8	12.5	15	12	14	16	17.8	21	23	25.5	23.8
Coal (million metric tons)	66.5	130.7	230	300	280	170	180	190	204	220	248	190	205	258	310	335	356	377	389
Electric power (billion kilowatt hours)	7.3	19.3	28	42	47	31	30	33	36	42	50	45	50	60	72	86	93	101	108
Crude oil (million metric tons)	0.44	1.46	2.3	3.7	5.5	5.3	5.8	6.4	8.7	10.8	13.9	13.9	15.2	20.3	28.5	36.7	43	54.5	65.3
Cement (million metric tons)	2.86	6.86	10.7	12.3	12.0	8.0	6.9	9.1	10.9	14.8	16.9	14.2	17.4	19.6	19.8	23.0	27.5	29.9	31.6
Chemical fertilizers (million metric tons)	0.4	2.1	3.2	3.3	3.6	2.9	4.0	6.6	7.6	10.7	13.2	13.8	15.6	17.9	21.4	24.2	27.6	32.2	30.5
Supply	0.2	0.8	1.4	1.9	2.5	1.8	2.8	3.9	5.8	7.5	9.6	8.1	9.5	11.3	14.0	16.8	19.9	24.8	24.8
Production	0.2	1.3	1.8	1.4	1.1	1.1	1.2	2.7	1.8	3.2	3.6	5.7	6.1	6.6	7.4	7.4	7.7	7.4	5.7
Imports																			
Machine tools (thousand units)	13.7	28.3	30	35	40	30	25	35	40	45	50	40	45	55	70	75	75	80	N.A.
Trucks (thousand units)	0	7.5	16.0	19.4	15	1	8.4	16.8	20.3	30	43	32	27	60	70	86	100	110	N.A.
Locomotives (units)	20	167	350	533	602	100	25	27	27	50	140	200	240	261	285	205	225	240	N.A.
Freight cars (thousand units)	5.8	7.3	11	17	23	3	4.0	5.9	5.7	6.6	7.5	6.9	8.7	11	12	14	15	16	N.A.
Cotton cloth (billion linear meters)	3.83	5.05	5.7	6.1	4.9	3.3	3.5	4.6	5.1	6.4	6.7	5.5	6.0	6.6	7.5	7.2	7.3	7.6	7.6
Foreign trade (billion current US \$)																			
Total	1.89	3.06	3.76	4.29	3.99	3.02	2.68	2.77	3.22	3.88	4.24	3.90	3.76	3.86	4.29	4.72	5.92	9.88	12.6
Exports f.o.b.	0.88	1.62	1.94	2.23	1.96	1.53	1.53	1.57	1.75	2.04	2.21	1.95	1.94	2.03	2.05	2.41	3.08	4.90	5.9
Imports c.i.f.	1.01	1.44	1.82	2.06	2.03	1.49	1.15	1.20	1.47	1.84	2.03	1.95	1.82	1.83	2.24	2.31	2.84	4.98	6.7

III. China's Foreign Trade in 1974-75

Highlights in 1974

China's foreign trade boom fell victim in 1974 to the growing problems of the world economy. Total trade increased by about 25%, to roughly \$12.5 billion, well below the 67% increase in 1973. Most of the increase is attributable to higher prices, with little or no growth in volume. Worldwide inflation pushed up China's import bill while the economic slowdown in the West cut demand for Chinese exports, resulting in the largest trade deficit in China's history -- perhaps \$1.3 billion with the non-Communist world, and despite a surplus with the Communist world, about \$1 billion overall.

Despite these difficulties, China's balance of payments is not in crisis. Reserves are well in excess of the trade deficit, the level of foreign debt is manageable, and Peking's credit rating is excellent.

China began taking steps to relieve the financial squeeze last fall. Contracts for agricultural products were deferred or canceled. Fertilizer deliveries were postponed. Peking also increased its use of short- and medium-term credits.

Trading Partners

Trade with the non-Communist countries posted the largest gains, accounting for almost 85% of China's total trade. Imports from the developed West shot up to slightly above \$5 billion from \$3.4 billion in 1973, largely due to increased purchases of agricultural products and machinery. China's deficit with the developed countries was roughly \$2.9 billion.

Sino-Japanese trade jumped 50%, to \$3.3 billion. China's imports, boosted by sizable deliveries of machinery and equipment, exceeded exports by more than \$800 million. China's exports of 4 million tons of crude oil worth about \$380 million more than offset the decline in its traditional exports to Japan.

US-China trade totaled \$935 million, a smaller increase than anticipated at mid-year because China canceled contracts for US grain worth about \$300 million. Wheat, corn, cotton, soybeans, and other agricultural products composed about 80% of total US exports of \$820 million (see the table). US machinery and equipment exports rose as delivery began on equipment for the ammonia plants purchased in 1973 and the second half of the \$150 million Boeing contract was

US-China Trade¹

	Million US \$		
	1972	1973	1974
US exports	63	690	820
Agricultural products	61	578	656
Of which:			
Wheat	35	278	234
Corn	24	132	96
Soybeans	....	43	140
Cotton	....	101	186
Vegetable oils	2	19	8
Machinery and equipment	2	69	107
Of which:			
Aircraft, including engines, parts, and accessories	....	63	76
Steel scrap	....	24	12
Other	....	19	31
US imports	32	64	115
Food, beverages, and tobacco	4	7	16
Bristles and other crude animal materials	8	8	10
Textile fibers	4	6	5
Nonferrous metals	2	8	11
Chemicals (including fireworks)	2	8	18
Cotton fabrics	2	7	26
Antiques and works of art	3	6	8
Other	7	14	21

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completed. Growing purchases of cotton textiles helped boost US imports of Chinese goods to \$115 million, up from \$64 million in 1973.

US-China trade encountered several problems last year. Chinese complaints over the quality of US grain caused delays in wheat shipments and the cancellation of soybean contracts. US controls on scrap steel exports prevented delivery on several contracts. On the import side, shipments of Chinese shrimp were rejected by the Food and Drug Administration, and the Chinese at the Fall Canton Fair were more vocal about the lack of most-favored-nation status for their exports.

Commodity Flows

Purchases of agricultural products, machinery, and transport equipment were largely responsible for the growth of China's total imports. China contracted for

almost 10 million tons of grain in 1974, but shipping delays and contract cancellations dropped actual deliveries to 7 million tons, down from 7.7 million in 1973. Higher grain prices, however, pushed the cost up to over \$1 billion. Imports of soybeans and cotton were up substantially from 1973. Machinery and equipment imports rose sharply as large-scale deliveries began on the \$2.5 billion worth of whole plants and other equipment ordered in 1973.

Peking signed contracts for \$900 million worth of whole plants in 1974 -- down from the record \$1.2 billion level in 1973. Rapid inflation and tight world credit markets, plus China's need for a breathing spell to absorb the large amount of technology already purchased, were the major reasons for the slowdown in purchases. Contracts worth \$550 million for the Wu-han steel rolling complex composed much of the purchases, with the balance going for additional synthetic fiber, fertilizer, and electric power plants. In contrast to the whole-plant program, new orders for machinery and transport equipment in 1974 were off sharply from the record level of 1973.

China's exports rose by roughly \$1 billion in 1974; petroleum accounted for almost half of the increase. Sales of crude oil and petroleum products to Japan, the Philippines, Hong Kong, and Thailand amounted to about 4.5 million tons worth \$440 million. Rice exports benefited from high prices, but other traditional Chinese exports, particularly silk and cotton textiles, faced declining demand.

Outlook for 1975

China's trade this year will be tempered by Peking's attempts to reduce its trade deficit. Export growth will be small, reflecting poor sales of traditional products at the 1974 Canton fairs and recession-weakened demand in the West. An expected doubling of petroleum exports may do little more than offset the decline in other exports.

Imports of machinery and equipment will be substantial as large-scale deliveries continue on 1973 and 1974 contracts. The successful 1974 harvest and declining textile exports will permit cutbacks in grain and cotton imports. Other, less essential imports will be curtailed and the pace of new plant contracts may slow further.

The \$700 million surplus enjoyed by the United States in its trade with China in 1974 will be cut sharply in 1975. US exports to the PRC could fall to one-third last year's level, while US imports will continue to rise. China's current low interest in US agricultural products stems from an adequate domestic crop last year, a determination to ease a tight foreign exchange situation, and dissatisfaction with

the quality of US wheat, corn, and soybeans. Peking canceled contracts for almost 1.0 million tons of US wheat in early 1975, thereby eliminating the United States as a supplier at least for the time being. As for cotton, contracts called for delivery in 1975 of 500,000 bales worth about \$100 million. Chinese interest in US cotton has diminished, however; one contract for 200,000 bales has already been canceled and additional cancellations may occur.

In contrast to farm products, US industrial exports should continue to rise in 1975. Although new orders for US machinery totaled only \$15 million in 1974, deliveries under 1973 contracts -- notably equipment for the eight Kellogg ammonia plants -- will peak in 1975. With export controls off, US sales of steel scrap could rebound to the 1973 level or higher. Gains are likely for such US manufactured goods as paper, aluminum, fertilizer, and other chemicals.

The steady rise in US imports of Chinese goods is likely to continue -- from \$115 million in 1974 to \$125-\$150 million in 1975. Chinese interest in the US market is growing at a moderate pace. Dramatic changes in products or marketing arrangements are not to be expected this year.

IV. The PRC Petroleum Situation

Introduction

Fifteen years ago, the People's Republic of China relied on the USSR for more than half of the oil it consumed. Today, China is the world's 13th largest oil producer and has emerged as a potentially large oil exporter. This paper briefly reviews the development of China's petroleum industry and the recent growth of its oil exports and assesses the prospects for future exports.

Energy Supply Position

The PRC produced an estimated 460 million tons (SFE basis)* of primary energy in 1974. In the late 1950s, China relied on coal for 95% of its primary energy. Since then the primary energy mix has undergone considerable change. As shown below, the role of coal has declined, while both oil and natural gas have risen in importance.

Percent of Primary Energy Produced

	1957	1974
Coal	95	64
Hydro	2	2
Natural gas	1	18
Oil	2	17

Currently energy supplies are tight: coal production has not kept up with demand. Although the rapid growth of petroleum production gives Peking the option of substituting oil for coal, the government has taken only limited steps in this direction, at least partly because of China's huge reserves of coal. More important, Peking appears to believe that increasing oil supplies are better used to expand the petrochemical industry and to earn much-needed foreign exchange.

Crude Oil Output, Reserves, and Exploration

China achieved self-sufficiency in crude oil production in the mid-1960s and in 1974 was the world's 13th largest producer, behind Indonesia. Crude oil output grew at a rate of 22% per year during 1965-74 and reached 65 million tons (1.3 million barrels per day) in 1974 (see the table).

* Standard Fuel Equivalent (calorific value of 7,000 kilocalories per kilogram).

China: Crude Oil Production

Year	Million Metric Tons	Thousand Barrels per Day
1950	0.2	4
1955	0.9	18
1960	5.3	106
1965	10.8	216
1966	14.0	280
1967	14.0	280
1968	15.0	300
1969	20.3	406
1970	28.5	570
1971	36.7	734
1972	43.0	860
1973	54.5	1,090
1974	65.0	1,300



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There are no authoritative estimates of oil reserves in the PRC. Proved reserves are thought to be at least 1 billion tons. Considering that large areas have not been surveyed, potential reserves probably are much larger. The main thrust of the Chinese exploration and development effort is still on land.

Offshore exploration has only recently begun and has been concentrated in the shallow Po Hai Gulf. The Po Hai deposits, which are adjacent to and probably part of the oil basin underlying the important onshore Ta-kang and Sheng-li fields, should begin to produce significant quantities of oil in the next few years. Activity in the deeper water of the Yellow, East China, and South China seas has been limited to geological surveys and preliminary drilling. During the last year, however, China has purchased about \$150 million worth of rigs and supply ships for offshore exploration. Aside from the development of the Po Hai, which should proceed

apace, other offshore exploration and development will be deliberate. PRC activity here appears to be based more on the fear that foreign rivals will stake out prior claims on the continental shelf, rather than on a need for additional oil.

Oil Refining and Transportation

The PRC has given high priority to refinery construction since the mid-1960s. Current refinery capacity is probably in excess of 50 million tons, and additional capacity is under construction. The progress in construction and the absence of Chinese interest in importing refinery equipment suggests that China is able to construct sufficient refining capacity for its own needs.

Transportation facilities have been pressed to keep pace with the growth of crude oil production. Until recently most of China's oil was carried by rail. Now, tankers and newly constructed pipelines are carrying rapidly growing quantities of oil.

Almost half of the domestic tanker fleet, which now totals about 600,000 DWT, has been acquired or built since 1971. About one-fifth of the crude produced is moved in domestic tankers (all smaller than 50,000 DWT), mainly from Dairen, Tsingtao, and Ch'in-huang-tao, to refineries in Shanghai and Nanking.

In 1974, the PRC completed two major pipelines, running from the Ta-ch'ing field in Manchuria to new oil-loading facilities at the port of Ch'in-huang-tao and from the Sheng-li field in Shantung Province to the port of Tsingtao. These pipelines are mainly to facilitate the export of oil, which previously moved to port by railroad tank cars.

Petroleum Consumption

Consumption of petroleum products by sector cannot be estimated with any precision, but it is clear that the sharply increased supply of petroleum is causing important changes in almost every sector of the economy. The increased use of petroleum in transportation and industry has characterized China's economic growth in recent years. The agricultural sector and the infant petrochemical industry particularly have benefited from plentiful oil. The leadership maintains strict control over the allocation of petroleum. Supplies are channeled to priority users, and recurrent campaigns are mounted for the conservation of petroleum.

Petroleum Exports: 1974 and 1975

Peking began to export crude oil in 1973 with the sale of 1 million tons of crude oil (20,000 b/d) to Japan. Prior to this, exports had been limited to small quantities of petroleum products for political allies such as Albania, North Korea, and North Vietnam. Four million tons (80,000 b/d) of crude oil, worth about \$400 million, were sold to Japan in 1974.* Another 250,000 tons of crude were to be shipped to the Philippines in the final quarter of 1974. China also exported small quantities of petroleum products to Hong Kong (200,000 tons) and Thailand (50,000 tons). Crude oil exports to Japan this year should reach 8 million tons (160,000 b/d), worth about \$700 million. The Philippines may receive 750,000 tons of crude oil in 1975. Hong Kong and Thailand will continue to receive small quantities of products.

Crude oil is a welcome addition to China's exports. Large imports of wheat and an aggressive program of whole-plant purchases, beginning in 1972, have forced Peking to seek new means of financing its trade. In the next few years, exports of petroleum will provide more than \$1 billion in hard currency annually, thus contributing measurably to China's ability to pay for its rapidly expanding imports.

Political Uses of Oil Exports

The agreements to ship diesel fuel to Thailand and to sell crude oil to the Philippines are part of PRC attempts to normalize relations with these states. Prospects of expanded shipments of crude oil to Japan were apparently used as leverage in the negotiations for the Sino-Japanese civil aviation agreement concluded in April 1974. Soon afterwards, Peking told the Japanese that they were ready to expand oil exports up to 10 million tons (200,000 b/d) in 1974 and to 50 million tons (1 million b/d) in 1980. Subsequently, several Japanese delegations have been to Peking to discuss a long-term oil agreement. The offer also appears to have been used to counter Soviet influence in Japan. China in effect offered the Japanese twice as much oil as they would have received from the Tyumen project (25 million tons a year).

Prospects for Oil Exports

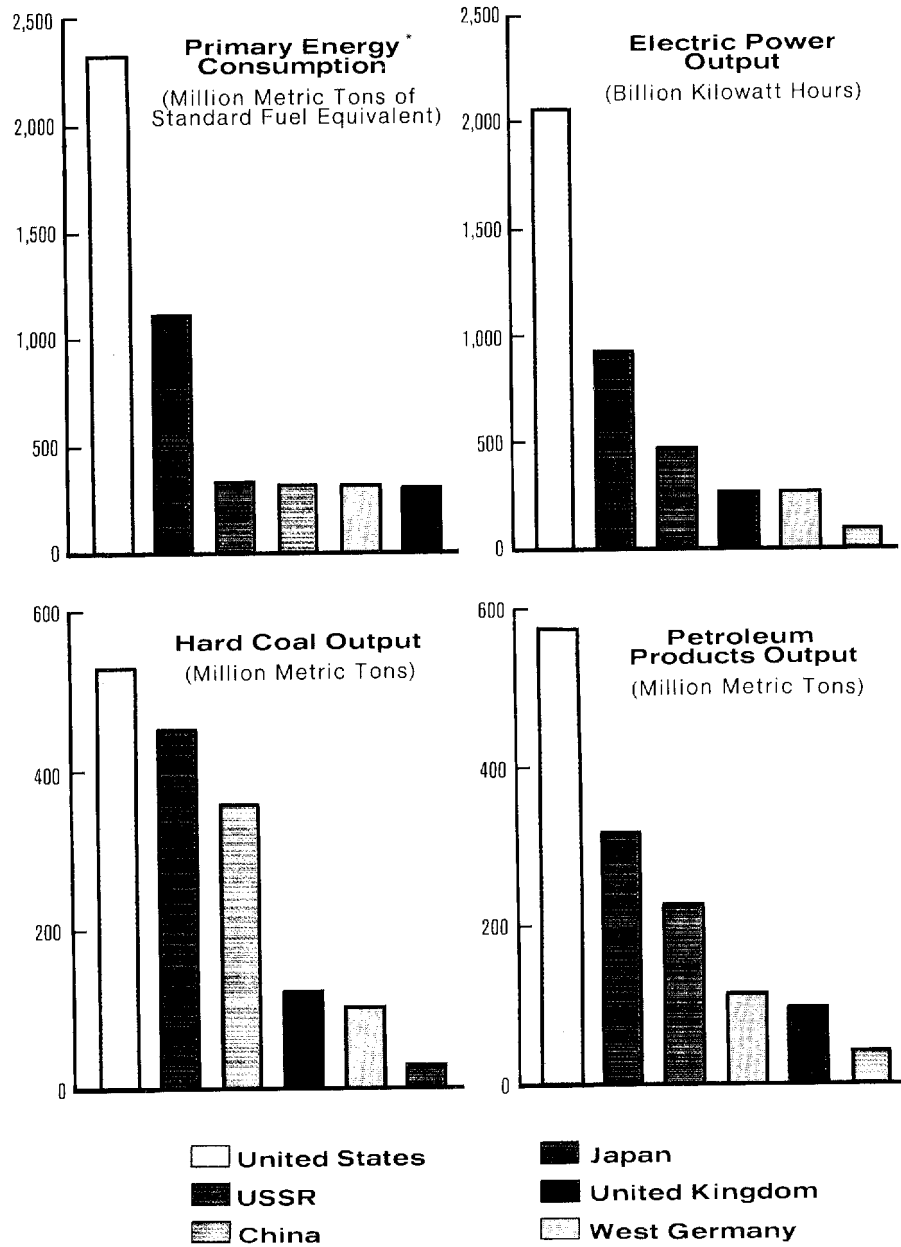
A goal of 50 million tons of crude oil for export in 1980 appears feasible. Reserves are large enough. If production continues to grow at 22% -- the rate achieved during 1965-74 -- the PRC could export 50 million tons in 1980 and

* PRC oil imports are nominal. Some crude is imported from Albania and the Middle East, and special products are imported from several other countries.

still have ample supplies of oil for modernizing the economy. Presumably most, or all, of any crude oil exports would go to Japan. If an agreement with Japan is eventually concluded, the export of 50 million tons of oil in 1980 would provide Japan with 12% of its projected consumption and, at current prices, would earn China more than \$4 billion.

If the PRC encounters unexpected difficulties in achieving the output of crude oil necessary to meet increased domestic and export requirements, it conceivably might change its attitude toward foreign participation in the development of its petroleum industry. China presently rejects joint ventures, direct foreign investment, and product sharing. Nevertheless, other arrangements cannot be ruled out. Exploitation of the deeper waters off the Chinese coast is likely to require foreign, and particularly US, technology.

Energy Comparisons, 1973



*Data are for 1972

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