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ECONOMY OF CHINA AND MANCHURIA

2013

10 April 1951

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## ECONOMY OF CHINA AND MANCHURIA

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**COLONEL SMARTT:** This morning, gentlemen, we conclude our presentations on the Soviet Union and the satellites with a lecture on the economy of China and Manchuria.

Our speaker this morning is an instructor in economics and regional studies, Harvard University. You have all read his biography. There is no need to go further into that.

I wish at this time to welcome to the platform of the Industrial College of the Armed Forces for the first time, Dr. Douglas S. Paauw. Dr. Paauw.

**DR. PAAUW:** Thank you, Colonel.

The Chinese-Manchurian economy is a very complex entity. I would like to stress general points in this brief discussion and if any of you have questions at the end, I would be very happy to go into more detail.

Writing in the "New York Tribune" in 1851, Karl Marx predicted that the Chinese economy would rot like a "mummy" when exposed to western imperialism via foreign trade. But we all know that this complete deterioration of the Chinese economy which Marx predicted never did take place. I think the reason for this is that at the present time and during the last 75 years, since foreign trade has become significant, two separate economies have existed in China. One of these is the native, rural, handicraft economy and the other, is the modern economy. The native sector of the Chinese economy is still the most important part of that economy. In this area both agricultural and industrial production are of the self-sufficient, handicraft type.

The modern sector of the economy is restricted to the coastal fringe, that is, to a limited number of cities along the coast and to the areas peripheral to these cities. In these areas there has been some import of foreign capital goods to establish the first stages of a modern economy.

But the important point is, I believe, that there is a very distinct difference between these two sectors of the Chinese economy and, consequently, there are important economic, political, and military implications. The rural sector of the Chinese economy is not subject to the kind of economic deterioration which can take place in a modern economy.

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I think the recent Sino-Japanese war bore out this point. The Kuomintang during that period allied itself with the rural economy and by that means was able to withstand persistent Japanese attacks.

On the other hand, the modern sector of the Chinese economy was subject to considerable deterioration during this period, and production declined to practically nothing by the end of the war in 1945. I think this same point can be seen in the fact that the Chinese Communists came to power on the basis of this rural, agricultural, self-sufficient, handicraft economy; that its power successfully arose in the postwar period, while the Kuomintang was allied with the modern, industrial sector of the economy. The civil war brought considerable destruction to this sector of the economy. Consequently, the kind of production on which the Kuomintang was attempting to rely deteriorated to practically no production at all.

With this basic distinction between the modern part of the Chinese economy and the rural, self-sufficient, predominant type of economy in China in mind, we can go into a brief survey of the basic economic resources of the economy. Here, the outstanding characteristic, I believe, is the extreme diversity of natural resources. Both as far as climate and topography are concerned, a good deal of diversity exists. The predominant land forms are mountains and plateaus. I think there are several economic implications of this type of climate and topography.

First of all, it means that there is considerable diversity from region to region in patterns of land use. It also means a wide distribution of mineral resources. On the liability side, this type of climate and topography causes a limitation of agricultural land. Something like 20 percent of all the land of China is or can be made arable. So, agricultural land is very limited, particularly relative to China's vast population.

Second, this kind of climate and topography means a great difficulty in exploitation of resources. Transportation and extension of transportation is very difficult in China. In the past, railroads have not been built into the interior provinces of Yunnan and Szechwan, precisely because of the topographical difficulties which were confronted. The wide distribution of mountains throughout China means that what mineral resources China has are widely dispersed. This, of course, makes their exploitation difficult. For example, iron is concentrated in Manchuria, coal is concentrated in North China, and other important mineral resources, such as tin and antimony, are concentrated in the southwestern provinces, especially in Yunnan.

In one sense China has considerable mineral resources; but in the genuine economic sense I do not think China has adequate resources to support large-scale industrialization such as we have seen in the West. In the first sense I believe that the mineral resources of Manchuria

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and north China are adequate to provide large-scale supplies for a limited period of years, but I do not think these resources are adequate to support full-fledged industrialization of the Chinese economy or significant extension of China's modern sector of the economy. I think this can be shown by a glance at the world distribution of mineral resources. While China has approximately one-fifth of the world's population, it has only one twenty-fifth of the world's coal supply. Yet coal is China's most important mineral resource, a resource in which it has the greatest reserves, estimated by the United Nations Report in 1949 at 244 billion metric tons. China's iron ore reserves were estimated at a little over 4 billion metric tons, which are not substantial reserves at all in terms of known western reserves.

So far as population is concerned, I think the significant fact about China's population at the present time is that it is characteristic of the population of a preindustrialized economy. This means that the population growth at this time is relatively limited, due to a kind of Malthusian balance between population and resources.

Both birth and death rate are very high. This suggests that with reduction of the death rate (which usually accompanies industrialization) potential expansion of China's population would be very great. According to the most careful study of China's population which has been made, a rather cautious sample made in Kiangsu some 15 years ago, it was found that approximately 83 percent of the Chinese population was concentrated under 45 years of age. This means that China's population on the whole is very young--young compared to western population. I believe this suggests something for potential manpower. My estimate of manpower between the ages of 15 and 45 at the present time would be something over 80 million males. There are approximately 160 million people between the ages of 15 and 45 in China at the present time, and something over 80 million males, since the ratio of males to females is about 1.09.

The geographical distribution of this immense Chinese population is very irregular. Approximately three-fourths of the Chinese population is concentrated in the eastern coastal area. The heaviest provincial population, paradoxically, is in the province of Szechwan, which is an interior province. The general principle of distribution of population in China is that population continues to follow food supply. It does not yet follow industrial output or mineral resources as it does in the West. The Malthusian balance between population and resources is largely a balance between population and food supply. This suggests that the greater part of China's population is concentrated in agriculture. Estimates of the amount of population concentrated in agriculture are usually put at some figure in excess of three-fourths of the entire population. The result is that the agricultural resources are utilized to the greatest possible degree. This concentration of resources in agriculture has forced productivity past the point of diminishing returns.

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As a result agricultural output per capita and even per acre is extremely low. This suggests that if part of the population were shifted from agriculture to other kinds of economic endeavor, agricultural output might increase rather than decrease. Per capita agricultural holdings in China are the smallest in the world. Not only that, these holdings are ordinarily subdivided into many parcels, which has serious implications for the collectivization of agricultural land, and for the ability to use mechanized machinery. At the present time, the implements which the Chinese peasant uses are very backward, being for the most part made of cast iron and bamboo. The basic power in agriculture is human power; hence the tools must be adapted to human power.

Communist land redistribution in China has actually added very little to agricultural productivity. Productivity has not increased significantly during the past year and a half even though Communist land reform in the important areas of the North and East has been largely completed. This suggests that the basic problems facing China's agriculture at the present time are economic and technical rather than problems of social relations, which probably have now been taken care of in this Communist redistribution program. The economic problem, of course, would be that of shifting population out of agriculture so the land could be effectively collectivized. The technical problems comprise such factors as the introduction of better varieties of seed, better methods of fertilization, more adequate irrigation facilities, and more careful preparation of the soil. Under the technical improvement program of the Japanese in Formosa, for example, the increase in agricultural output, largely attributed to these technical reforms, amounted to something like 50 percent.

The Chinese Communists have been struggling with this problem of food supply. As you know, no doubt, last winter China experienced a very serious famine, especially in the eastern and central areas. To deal with this problem, a large amount of grain was sent from both Manchuria and the province of Szechwan to the food-deficit areas. This suggests, I think, a fact which is generally true, namely, that Manchuria is normally a food surplus area. Manchuria has recently been exporting wheat to Russia in return for industrial goods.

So far as industrialization in China is concerned, I think that a very cautious estimate based on "gross national product" studies would indicate that approximately 10 percent of the Chinese gross national product is contributed by industry. This agrees with a figure put out by the Chinese Communists last year. In this country something over 30 percent of the gross national product is composed by industrial output. But the important point is that there is a great qualitative difference between Chinese industrial production and western industrial production. Approximately 80 percent of the output of industrial goods in China represents handicraft production, the kind of production which is based primarily on human power. The ability to destroy this type of industry is limited since it is dispersed throughout the countryside.

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So, as a generalization, I think we can say that China's industry is both concentrated and dispersed. The modern part of China's industry, which represents something like 10 percent of industrial production, is very highly concentrated. Something like 90 percent of the modern industry of China proper is concentrated in six coastal cities, and approximately one-half of this is concentrated in and near Shanghai.

Heavy industry is largely found in Manchuria. The origin of this heavy industry, as you all probably know, was during the period of Japanese control in Manchuria. Originally, the Japanese policy in Manchuria was to establish raw material producing areas, the objective being the export of iron ore and coal to Japan where the finished goods would be produced. But later in the period of Japanese control, there was a tendency to allow production of finished goods in Manchuria. Hence, a limited amount of armament production, chemical production and capital goods production arose in Manchuria during the late 1930's and early 1940's.

So far as Manchurian industry under the Chinese Communists is concerned, there is concentration on the production of capital goods. According to the Kao Kang Report "The Economic Situation in the Northeast," approximately 74 percent of the total industrial production of Manchuria was devoted to the production of capital goods, that is, to the production of equipment which could eventually produce finished goods, military supply goods, consumers goods, etc.

The general characteristic of industrial output for China as a whole, looking at both China proper and Manchuria, is concentration on the production of consumption goods. This was especially true during the 1930's when industrial output was oriented more toward the West than toward the native Chinese economy. Something over three-fourths of all industrial output was consumption goods; whereas in the western countries it is quite the reverse.

There is some indication that during the Communist period there has been a shift in emphasis toward the production of capital goods in China proper as well as in Manchuria, but the necessity to import capital equipment from Russia in order to make this conversion has limited this tendency. The Chinese Communists, for instance, have reported phenomenal gains in industrial output in Manchuria, especially in the output of heavy industry, for the year 1950. Now, of course, these reports should be carefully scrutinized. But I would like to give you the Chinese Communist figures for your information.

According to the "Hsin Hua Yueh-Pao," which is the "New China Monthly," iron ore production in 1950 increased by 11 times the amount produced in 1949; steel production increased 7.8 times; and cement production 3.8 times. Some discrepancy is suggested by the fact that the Kao Kang Report, to which we referred earlier, had suggested that

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Manchurian industrial production in 1949 (in publicly owned industries) was at only 29 percent of the amount produced by the Japanese in 1943 and 1944. I fully realize these figures are unsatisfactory since they look at industrial production as a whole, rather than by industry; but these are the only figures available from Chinese Communist sources.

The Chinese Communists claim that the Russians have been extending considerable aid in rehabilitating the Manchurian section of the modern Chinese industrial economy. For example, just a few days ago, the "Hua Ch'iao Rsh Pao," which is the "Overseas Chinese Daily," reported that the Russian Communists had turned over to the Chinese all industry in Port Arthur and Dairen, which the Russians took over at the end of the war. It also indicated that these industries had been considerably expanded; that in three fields--electricity, machine production, and shipbuilding--the Russians had concentrated on training Chinese technical personnel. The particular report to which I referred suggested that in those three fields something over 4,500 technicians were trained by the Russians so the industry could be turned over to Chinese control. Now, if these reports are true, it seems to indicate that the Russian policy is one of establishing Manchurian heavy industry on its own feet, sending in capital goods to rehabilitate the industry, and training Chinese technicians to operate the industry.

There is some question about the extent to which the Russians can assist in this rehabilitation of the Chinese economy. First of all, why do we say, "rehabilitation"? During the postwar period a good deal of Manchurian industry, especially, was destroyed. In addition there were the Soviet removals of Manchurian industry which concentrated on removing the modern type of equipment from the factories, equipment which had been most recently built by the Japanese. For example, 95 percent of all the rolling stock was taken from Manchuria by the Russians, according to the Pauley Report. The new Mukden Arsenal was completely stripped, while only a portion of the facilities (one-third) of the old Mukden Arsenal were taken.

The Russians have attempted to assist the Chinese in rehabilitating this ravaged industry. Officially, they have agreed to extend a 50-million-dollar credit annually to the Chinese which will finance the import of capital goods, capital equipment, electrical equipment, equipment for the producing of metallurgical goods, etc. But my point is that I believe the economic aid which the Russians can extend to the Chinese is rather limited, and hence the ability of the Chinese to produce industrial goods at the level which the Japanese produced in 1943 and 1944, which is the period of maximum Japanese production in Manchuria and north China, cannot be reached by the Chinese Communists even with Russian support in the near future.

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During the five years 1945 to 1949 the American Government extended something like 3 billion dollars of aid to the Chinese for economic rehabilitation and military assistance. Even this relatively large amount of aid did not materialize in substantial gains in production, although it must be admitted that most of the economic aid never reached its destination.

The Chinese Communists have, in the period since they have taken over, concentrated on the rehabilitation of industry, on replacing industrial equipment in factories which already existed, rather than on the extension of industry. The indication is that a good deal of credit arranged between China and Russia has gone into the reconstruction of China's railroads. The Chinese Communists have recently claimed that all the railroads which were in operation in 1937 and which were largely destroyed during the war have now been replaced. For example, in 1947, only 10 percent of the railroads in Manchuria were in operation. Today the Chinese Communists claim--and this claim seems to be true, as borne out by statements from Henry Lieberman, for example--that all railroads in Manchuria are operating. A few days ago the Chinese Communists declared that for the first time in China's history railroad transportation is available from the north Manchurian border all the way to the south Chinese port of Canton.

Looking at their claims objectively, it appears to be true that the rehabilitation of the railroads has been stressed. This still does not mean that transportation in China is adequate. The rail system is very limited. In China proper, railroads are largely limited to the coastal areas. There are no railroads into the important interior areas of Szechwan and Yunnan.

Practically all modern Chinese industry has been built by the importation of foreign capital and even in this postwar period, reconstruction of Chinese industry is on the basis of the import of capital from the Soviet Union. I think this indicates a very important point, which is this: That the Chinese have great difficulty in accumulating capital and in establishing modern industry since the pressure of population on basic economic resources is so great.

However, I think it is important to recognize the fact that in China there exists a large amount of what is called "surplus labor." The agricultural population finds a good deal of idle time, especially in the winter months. Recognizing this factor of surplus labor, attempts have been made to channel the population off from agriculture in order to create capital goods, such as irrigation works. However, the important point here is that unless this surplus labor can be given an initial complement of capital goods, China's industrialization will continue to be relatively limited. The question arises as to whether or not the Russians are willing and able to provide a large amount of capital goods

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to complement the surplus labor from agriculture. I think the possibility is very limited.

Now, I would like to spend a few minutes on the Chinese Communist's economic problems and policies in the postwar period. With what kinds of economic problems have the Chinese Communists been confronted? What attempts have they made to solve these problems?

The problem of food supply has, of course, always been a very important problem in China, and the Chinese Communists have directed their first efforts toward this problem. It is difficult to tell whether or not the Chinese Communists believe that land redistribution in the Communist sense did anything to increase the food supply. As we have already indicated, agricultural production was not increased significantly by the Communist land reform. I think that basically the Communist land reform program in China was a political program to enlist the support of the peasant and to destroy the power of the landlord class rather than an effort to increase agricultural production.

I think this policy of the Chinese Communists should be looked at in the broad light of attempting to establish control over the entire Chinese economy. The Chinese Communists have already indicated that eventually they intend to collectivize China's agriculture; and that this collectivization will begin as soon as the time is ripe. The Chinese Communists fully realize this is important for centralization of food supply necessary for industrialization and large-scale military operations.

Since agricultural production was not increased significantly by land reform, the Chinese Communists have now turned to other policies to stimulate agricultural production. They have set up model farms to teach new methods and have been paying out bonuses to peasants who have increased agricultural production significantly. They have also undertaken technical reform programs. As I have indicated previously, I believe that improvement along this line could increase food supply and general agricultural production significantly.

The other important set of economic problems which have been dealt with by the Chinese Communists are those concerned with the control of inflation, the deficit in the state budget, and the problem of establishing general control over production and distribution of goods. I think that this set of problems is interrelated.

The Chinese Communists claim to have solved the problem of inflation. This is only an aspect of establishing control over the general economy. I think the matter of the deficit in the state budget is also an aspect of the problem of establishing general control over the economy. The

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absence of price inflation becomes relatively meaningless when prices are dictated by the Government, when prices are no longer indicative of consumer demands, when the mechanism of prices is not allowed to function normally. And I think the problem of deficit in the state budget also becomes relatively meaningless when political and economic control is not sufficient to enable the state to siphon off adequate real goods to meet every expenditure the Government plans. The monetary aspect becomes less significant than the control over real goods.

The Chinese Communists have set up a number of organizations to extend their control over the economy. One very important organization called by the Chinese Communists the "National Organization Committee," was set up in March 1950. This committee was henceforth to have complete control over the allocation of manpower. Since this legislation was passed by the Chinese Communists, the military, industrial enterprises and government agencies have been required to apply to the National Organization Committee in order to obtain manpower. I think this committee is important since for the first time in Chinese history there is an attempt to allocate manpower among those who demand that sort of resource.

In the same month (March 1950) the Chinese Communists set up a number of state trading agencies which were to be under the joint control of the Ministry of Trade and the Financial and Economic Committee. In the past year, these state trading agencies have been very important to the Chinese Communists in establishing control over economic resources and have enabled the Chinese Communists to mobilize resources more effectively than the Kuomintang government was able to do.

The functions assigned to the state trading agencies are very broad. They include complete price control--control of both prices of resources of production and prices of final output. Normally, both state enterprises and the private industries which still exist are required to operate through the state trading agencies. Basically, therefore, these agencies are the means by which the Chinese Communists are establishing control over the allocation of resources, which allows them to use resources in accord with their desires.

Now, I would like to say a few words on Sino-Russian economic relations and foreign trade in general. I think that an attempt to discover the kind or the pattern of trade which is taking place between China and the Soviet Union is basically a matter of intelligence. The Chinese Communists have issued a number of reports on trade; but we can never be certain as to the reliability of these reports. There are indications that the basic pattern of trade is export of raw materials and handicraft products from China to the Soviet Union and the export of capital goods from the Soviet Union to China. There are also indications that the Russians are not using some of the products they receive from China directly but rather are re-exporting these materials such as Chinese pig bristles, to Europe at higher prices, thus obtaining access to valuable foreign exchange.

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A Chinese Communists' report in the "Overseas Chinese Daily" suggests that in the past few months there has been a heavy export of the following goods from Russia to China: First of all, industrial equipment (tooling and die machines are specifically mentioned); second, transportation and communications materials; and third, agricultural machinery.

Now, if this report is true, it appears that the Soviet Union is interested in developing Chinese industry to maintain Chinese military potential, rather than to establish a central base of industrial production in the Soviet Union, as the Japanese attempted to do under the East Asian Co-Prosperity Sphere.

According to the same report, China's exports to Russia were predominantly raw materials, including such products as silk, wool, wheat, soybeans, tea, and handicraft products. Paradoxically, this report suggests that the Russians have paid higher prices for these articles than the Chinese had previously obtained from western countries, while prices on industrial products purchased from the Russians are considerably lower. This does not agree, however, with the fact that the Russians have been re-exporting Chinese goods into Europe at considerably higher prices.

China's foreign trade at the present time is under the strict control of the state. Exports and imports are ordinarily made by state enterprises; the limited amount of private trade that does take place is required to go through the process of licensing through state trading agencies.

Chen Yun, who is the chairman of the powerful Financial and Economic Committee, recently reported that only essential items are imported into the Chinese economy, and these, as we have indicated, are largely capital goods. He also stressed the fact that the "unfavorable" balance of trade has been reduced for the first time in the past 70 years. This is rather paradoxical since most economists believe that, in the stage of economic development in which China finds itself at the present time, an "unfavorable" balance of trade is desirable (even though the term does not suggest that) since it means the addition of real goods to the limited product of a backward economy.

Except for trade with the Soviet Union, practically all trade during the Communist period has flowed through the port of Hongkong on a re-export basis. The Chinese Communists have been particularly importing such raw materials as cotton and rubber from Southeast Asia through the port of Hongkong. This indicates that the production of cotton in China is not adequate to meet the growing army demand for cotton uniforms. During the past few months, however, it appears that trade with non-Soviet countries has declined. Hongkong trade, both import and export trade of China, seems to have declined as the result of the de facto blockade since transshipment from Hongkong to Chinese ports by water is practically impossible.

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In the next minute or two I would like to suggest a few general conclusions. I think that, first of all, this brief survey of the Chinese economy suggests that the Chinese economy itself has considerable ability to withstand military and economic attack since, predominantly, the Chinese economy remains of the rural, self-sufficient, handicraft type.

Second, I think the survey of the Chinese economy indicates that China's economic contribution to the economic strength of the Soviet Union will be rather limited. China can export some strategic minerals, but it has no oil to export to Russia. The fact that Russia is re-exporting a large amount of the raw materials which it has obtained from China through the trading agreement seems to indicate that the Soviet Union itself cannot use the materials in which the Chinese economy has a surplus. Of course, the re-export of materials gives the Russians access to western currencies, which may be useful. On the other hand, I feel that the Russian contribution to China's economic and military potential can be very great if the Russians are able to continue some injection of capital goods into the Chinese economy. This, of course, is dependent upon a study of the Russian economic potential.

Thank you.

(26 July 1951--650)S.