Peking halves capital investment, and jeopardizes the China Card

by Richard Katz

Only the most desperate farmer will slaughter his breeding stock or devour his seeds. Unlike the 1958-60 Great Leap Forward, the current economic crisis in China has not yet descended to that level, but the state of mind of the regime has. China just announced a *near-halving of its capital investment* for 1981. Going beyond any previous shift from heavy to light industry, the new measures strike at the core infrastructure of energy and transport. If continued, such cutbacks doom any hope China ever had of becoming an industrial or military power.

While some Westerners, including some U.S. State Department sources, applaud Deng Xiaoping as the David Stockman of the Far East, others fear that Deng's latest move undermines China's credibility as an economic-military power. That in turn would jeopardize the whole "China card" geopolitical strategy so carefully built up since Henry Kissinger's 1971 visit to Peking.

Deputy Prime Minister Yao Yilin, a Deng factional ally, announced the new investment-gutting measures at a Feb. 25 meeting of the Standing Committee of the National People's Congress, China's nominal legislature. Yao announced that the overall national budget for 1981 would be cut $10 billion (14 percent) to $65 billion, but that the capital-investment portion would be cut by an astounding 45 percent ($16 billion) to only $20 billion. In addition to the overall cuts, $6 billion was shifted from investment to immediate consumption, as well as to light industry. The previously sacrosanct areas of energy and transport were included in the cuts, although factories are already being closed due to bottlenecks.

Part of the political motivation surrounding the frantic measures—the need to buy off an increasingly restive population—was revealed when Yao announced wage bonuses to scientific, health, and other workers bypassed in the last round of the now-suspended bonus program.

Political considerations also came up during Peking's discussions with Japanese emissary Saburo Okita. Okita had been sent to Peking to demand an explanation, and compensation, for China's abrupt cancellation of $1.5 billion in contracts with Japanese firms for projects in steel and petrochemicals. Ironically, Okita is the eminent Japanese development economist China had hired in 1978 to critique their economic plans. According to the Feb. 20 issue of the *Far Eastern Economic Review,* in addition to demanding compensation, Okita warned the Chinese leaders that their light-industry orientation is inherently inflationary and will preclude real economic development. Okita was informed in turn that certain political problems necessitate a stress on immediate production of consumer goods.

The "certain political problems" are the workers' strikes and food demonstrations that have spread to several Chinese cities, as well as the rural demonstrations against high prices for consumer goods. In addition, Yao pointed out in his speech the powderkeg of 20 million urban unemployed. Yao did not mention that many of them are unemployed because Deng's previous measures had shut down many factories.

Deng can ill afford a repetition of the mass unrest that occurred during the 1976 economic downturn. He has yet to consolidate his grab for total power. Despite an ongoing purge of military and civilian opponents who favor heavy industry, opposition is still so active that Deng has been unable to convene the Communist Party Central Committee Plenum and Party Congress originally planned for January. Such convocations are necessary if he is to stuff the party with his supporters and ensure his dynasty.

The energy crisis

The new budget is not simply a continuation of the Dengist shift to light industry announced at the September 1980 National People's Congress, notwithstanding U.S. State Department reports. It is a crisis-management tactic brought on by an unforeseen economic crisis that hit China during the October-December quarter.

For 1980 as a whole, China claims an 8.4 percent growth in industrial production—divided between a one-shot 17 percent spurt in light industry and a dismal 1.6 percent rise in heavy industry. A comparison of the 8.4 percent final figure with much higher claims earlier in the year indicates a sharp dropoff in growth, perhaps even an actual downturn, beginning around the final quarter of 1980.

At a hastily convened Central Committee working conference in January 1981, newly installed Dengist Premier Zhao Ziyang began to reveal the dimensions of the crisis in a secret speech. The production dropoff had been so severe as to double the 1980 budget deficit to $8 billion from the $4 billion projected in September.

Zhao stated the crunch would worsen in 1981. The measures outlined in the Feb. 25 Yao Yilin speech were prepared. The first public hint of this was the burst of cancellations of foreign contracts beginning in January.

Yao's speech revealed more of the details of the crisis. Oil output will fall from the 1980 level of 106 million tons to only 100 million tons this year, and keep falling to only 80-90 million tons by 1985. In 1978, China had predicted a 240 million ton output by 1985—and was widely believed. Yao revealed that coal output will fall 6 percent in 1981 alone from 358 million tons to 339.

Yet Yao announced that China would cut investment in oil and coal. As late as last fall, Deputy Premier Bo Yibo had told *China Business Review* that energy was a priority, along with light industry and transport. While details have yet to be announced, informed sources indicated the nature of some of the cuts. In oil, China will probably reduce 10 major inland oil exploration and drilling projects costing billions of dollars, in favor of production-sharing joint ventures with foreign firms for offshore exploration, in which China lays out minimal cash in advance.

In the coal area, the problem is more complicated. China mines sufficient coal, but lacks the transport infrastructure to bring it to users, and the crushing, washing, and preparation equipment that make it suitable for modern mills. Peking has not yet revealed whether the cuts in coal affect the mining or the transport and ancillary equipment, or both.

In addition, the absolute amount of investment in producing thermal power plants will be cut in 1981.

Won't these energy cutbacks close more factories and lay off more workers? "China is cutting steel this year from 35 million tons to 33," replied one U.S. corporate official. "That will free up a lot of energy. Other cuts in heavy industry will have to be the major energy source." Cannibalism of the existing industrial base? "Yes." Peking calculates that for every 1 percent shift in the ratio of light to heavy industry in the economy—now at 46:54 in favor of heavy—it saves 6 million tons of coal. With a 20 million coal drop this year, Peking will have to cut heavy industry 3 percent just to keep light industry even, never mind growing.

Specific transport cuts have not yet been announced. Some sources suggest that they could mainly affect water transport and also perhaps not-yet-begun rail projects. An additional area of cutback is the defense budget—a step likely to increase the military's already acute disenchantment with Deng. It also gives China Card advocates in the West pause for thought.

Though Deng may be able to pay wage bonuses today through the investment cutbacks, the measures definitely portend layoffs, living standard declines, and greater political turmoil for the not-too-distant future.

China Lobby debate

Immediately following the Yao Yilin speech, the International Monetary Fund (IMF) announced that China had drawn down $550 million in Special Drawing Rights from the IMF, plus an undisclosed sum of soft-term loans. The *New York Times* quoted IMF officials commenting approvingly that the latest budget cuts would alleviate China's inflation. Similarly, former Federal Reserve Chairman Arthur Burns—a reckless proponent of the David Stockman version of the Yao Yilin policy in the U.S.—visited China just prior to the Yao speech and reportedly discussed the budget crisis. It is not known exactly what Burns proposed, but Chinese officials were later heard relaying to Japanese representatives the Friedmanesque nostrum that Peking had to end the budget deficit in one year "in order to cut inflation."

More sober Western advocates of the China Card geopolitical strategy, previously ardent admirers of Deng, are openly chastising him for his latest moves. Giving Deng the new monicker of "arch-devolutionist," the March 2 London *Financial Times* reports that even a mission from the IMF, which normally insists on economy-shattering conditionalities, "was apparently taken aback by such a ferocious assault on public investment. . . . It risks leaving China littered with half-built plants, a monument to wastefulness on a gigantic scale." The *Financial Times* warns, "Meanwhile, new unemployment climbs by the millions. . . . Unemployment and growing inflation can only aggravate political unrest."

Deng is trying to shore up his regime by asking for Japanese support, including very low-interest loans plus aid in importing oil, a ploy chastised by some as "robbing Paul to pay Paul." Some Japanese officials, including Economic Planning Agency chief Toshio Komoto are reportedly advocating such help on the grounds that "Asia needs above all a stable China." Other officials add, "Deng and his colleagues need all the help they can get."

The London *Financial Times,* although damning Deng's latest move, agrees on shoring up the regime. The question is whether the Humpty-Dumpty economy can be put back together again—and if that fails, will Deng suffer his third and final fall from power?