

Socialist Construction in China

Socialist Construction in China:

*Policies Under Central Planning
and Post-Reform Era*

By

Abdol S. Soofi

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To Dong-Xing, my connection to China's culture

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PREFACE

After economic stabilization during 1949-1952, the founders of the People's Republic of China began industrialization by initiating the First 5-year Development Plan (1953-57). After a decade-long implementation of the developmental policies, the leaders of the Communist Party of China (CPC) dealt with the crucial questions of building socialism. They were searching for a mechanism to develop a socialist society. The CPC searched for a guideline that combined Marxist principles and socio-economic characteristics that prevailed in post-revolutionary China. Moreover, after three decades of socialist construction, the leaders of the CPC had to address “irrational economic structure,” excess capacity in some industries, and shortages in others.

Li, Fu-Ch'un, Chairman of the State Planning Commission, in the Report on the First Five-Year Plan in 1955, stated, “The capitalist system of private ownership of the means of production hinders the further development of the productive forces of our country. The anarchy of capitalist economy runs counter to the planned development of the socialist economy.” (Li, 1955, p. 47). However, Ma Hong, President of the Chinese Academy of Social Sciences, two decades later wrote, “Today we are all recognizing the irrationality of an economic structure that has built up over the years, that highlights “steel,” and that focuses on heavy industry, then light industry, and last agriculture, in that order. We are recognizing the irrationality of an economy that is cut off from the rest of the world. The main issue we face is how to change this irrational economic structure so that our economy can meet the needs of an accelerated “socialist modernization.” (Ma, 2014, p. 5)

This book aims to identify what policies and events led to such a radical change in the position of the leaders of the Communist Party of China. Accordingly, the book reviews the economic planning and policies in China under socialism, which led to not only unprecedented economic growth in the history of humanity but also to the structural imbalances that required a massive rebalancing of the economy, economic reforms, and during the last two decades of industrial restructuring, further modernization.

The proposed book reviews the events and policies in three parts to achieve this goal. The first part deals with the origin of the hyperinflation of 1937-

1950 and the anti-inflationary and price stability policies of the era. The discussion in the first part shows some of the policies adopted after establishing the People's Republic, which originated in the Chinese Soviet era of the late 1920s until 1937, and the Border Areas from 1937 to 1945. The second part discusses economic planning, socialist construction, and resource misallocation under central planning. The third part deals with the reasons for the misallocation of resources and imbalances that led to the economic reforms in 1978. The book's third part also examines whether the economic reforms remedied the problems of imbalances that prevailed under central planning. Specifically, this part reviews the evolution of the reform policies presented at the National Congresses of the Communist Party of China, from the 13th National Congress in 1987 to the 20th National Congress of 2022. Moreover, the supply-side structural adjustment reforms that began in early 2000 are reviewed, and resource misallocation and policy reversal are examined in the context of developing excess capacity in some of China's strategic industries by focusing on China's iron and steel industry.

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2. Ma Hong (2014) *Chinese Economists on Economic Reform-Collected Works of Ma Hong*, London: Routledge.

PART I

PRICE INFLATION AND FINANCIAL STABILIZATION POLICY IN CHINA: A HISTORICAL REVIEW

Decades of war, revolutionary upheaval, and economic mismanagement in China during the first half of the 20th century caused chaotic economic conditions in the country before the establishment of the People's Republic of China on October 1, 1949. Speculative mania, high-interest rate, hyperinflation, inadequate private or public investment in the real sector of the economy, shortages of essential consumer goods, and mass unemployment characterized China's economy at the time. However, shortly after its establishment, the Central People's Government (CPG) restored price stability and increased the output of agricultural and industrial products to the level before Japan's second invasion of China in 1937.

Starting with the establishment of the first Chinese Soviet Republic in November 1927 and the Japanese occupation of Manchuria in September 1931, until the capitulation of the Army of the Empire of Japan in August 1945, China's economy was divided into three regions that were controlled by the Chinese revolutionaries, by the Kuomintang central government, and by the Japanese Army. The areas under the control of the People's Liberation Army (PLA) were first called the Soviet Areas (1931-1937), then "Special" or "Border Areas" after the conclusion of the peace agreement between The Communist Party of China (CPC) and Kuomintang (from 1937 until 1945), and then "Liberated Areas" after the defeat of Japanese Army in August 1945.

This part of the book traces the historical roots of China's chaotic economic condition and hyperinflation in the 1940s and then reviews the monetary and anti-inflationary policies after the establishment of the CPG. The review includes discussions of the money and banking in the Chinese Soviet, Border Areas, and Liberated Areas before the downfall of the Kuomintang government. Moreover, Chapter one of Part I discusses the economic conditions that prevailed in the areas under the control of the Kuomintang

central government. In this narrative, I will first review the hyperinflationary condition in China before the downfall of the Kuomintang government and then examine the anti-inflationary policies of the Kuomintang, which resulted in patent failure. Next, the People's Central Government's anti-inflation policies, from October 1949 until January 1953, are discussed in Chapters 2, 3, and 4. The policies from the start of the First Five-Year Development Plan in 1953 until the end of the decade are reviewed in Chapters 5 and 6. Finally, Chapter 7 reviews policies to increase agricultural output as an anti-inflationary measure.

CHAPTER 1

MONEY AND BANKING IN THE CHINESE SOVIET REPUBLIC, BORDER, AND LIBERATED AREAS: 1927-1949

A comprehensive discussion of price stabilization policies in China after the establishment of the People's Republic requires placing the formulation of the policies in the historical context of the country's economic development. Reviewing the policies of the period before the formation of the People's Republic of China is informative because many anti-inflationary policies after the establishment of the CPC were a continuation of the policies adopted by the CPC during the Chinese Soviet era. As the first step in reviewing price determination and anti-inflationary policies in China during the 1950s, this chapter deals with the development of policies from 1927 until October 1949.

Changes in the Areas Under the Control of the Communist Party of China

As was stated in the introductory comments to Part I of the book, the areas under the control of the People's Liberation Army (PLA) during the Kuomintang era changed in size depending on the military situation. The areas were initially called the Chinese Soviets (November 1927- September 1937), then the name changed to “Special or Border Areas” (September 1937-August 1945), and finally, the name again changed to “Liberated Areas” (August 1945-October 1949).

The first Soviet Area, Hai-Liu-Feng Soviet, was established in some Kwangtung (Guangdong) Province regions in November 1927. Until 1930, the Chinese Soviets did not control large territories and had no economic policies; however, in 1931, the Chinese Soviets developed and implemented economic policies. Moreover, after the start of cooperation between the CPC and the Kuomintang on 22 September 1937 in response to the Japanese

invasion of North China in July of the same year, the CPC “liquidated” the Soviet government.

The first Border or Special Area was the Shan-Kan-Ning, established in North Shensi (Jiangxi) Province, and eighteen border areas of different sizes existed in various provinces during the period. However, after the Japanese surrender at the end of WW II, these Border Areas consolidated and formed the “Liberated Areas.” (Miyashita, 1966)

The Border Areas were established in the following seven Provinces: Kiangsi, Hunan, Hubei, Anhui, Honan, Fukien, and Szechuan. Estimates are that the area under the CPC rule was over 100,000 square miles and had a population of 36 million people. (Miyashita, 1966, p.8)

Adoption of the First Economic Policy

After the proclamation of the Provisional Government of the Chinese Soviet Republic, 610 delegates at the First National Congress of the Chinese Soviets that convened in Kiangsi on 7 November 1931 also passed the first formal economic policy of the Provisional Government by adopting a Resolution (Waller, 1973). The Resolution was based on the economic issues and policies discussed by the members of the Central Committee of the Chinese Communist Party at the Party Congress.

The articles relating to the economic issues in the Resolution were about industry, commerce, financial administration and taxation, and municipal administration. (Miyashita, 1966, P.5). The resolutions regarding the economic policies of the Chinese Soviet area are not available in English. However, the documents containing the resolutions of the First National Congress, among other official records and publications, were left behind by the revolutionaries at the time of their Long March¹ were found by General Ch'en Ch'eng, the Vice President of the Republic of China, who led the military campaign against the Soviets during the 1930s. These documents were released later and became known as Ch'en Ch'eng Collection². Moreover, even though the researchers have dealt extensively with the political aspects of the Kiangsi Soviet (Womack, 1982; Waller,

¹ The Long March began on 16 October 1934.

² The documents are available in microfilm at Hoover Institute, Stanford University. Another collection set is available at the Modern China Research Center in Japan.

1973), little has been written on the Resolution of the economic policy (Wu, 1970)³

What follows is a sketch of the central economic policies adopted by the Chinese Soviet government and the more in-depth discussions of money and the monetary policies of the Chinese Soviet areas.

Commodity Shortages and Government Finance in the Chinese Soviet Areas

Kuomintang's blockade of the border areas compounded the economic problems of the Chinese Soviets. The regions under the control of the Chinese Soviets were rural and had no manufacturing capability, and handicraftsmen produced most of the manufactured goods (Waller, 1973). Accordingly, trade with the economy under the control of the Kuomintang government had to take place through underground channels. Moreover, the regions under the control of the Chinese Soviets faced an acute shortage of basic food staples such as grain and salt⁴ (Wu, 1970).

In addition to food shortages, the Chinese Soviets also had to contend with public finance problems. We will discuss the methods of raising revenues after establishing the Central People's Government below; however, suffice it to say here that the captured CPC documents in Kiangsi by the Kuomintang army show that during 1933-34, in addition to funds raised by expropriation of properties of the big landlords and counterrevolutionaries, the Soviet government issued three million Chinese dollars bond on 28 August 1933 (Wu, 1970, p. 407). Additionally, the Chinese Soviet government borrowed grain from the peasants to feed the members of the PLA. For example, the People's Commissar called for "Emergency Mobilization of 24,000 Tans of Grain to the Red Army"⁵ on 5 June 1934. Shortly after, on 26 July 1934, the People's Commissar announced the "Decisions on Borrowing 600,000 Tons of Grain in the Autumn Harvest of This Year and Levying on Land Tax" (Wu, 1970, P. 407).

The shortages of agricultural and manufactured goods in the areas under the control of the CPC, which began in the 1930s, continued into the 1940s in the Border Areas. Describing the acute shortages of essential foods and

³ For a list of the topics and contents of the Ch'en Ch'eng Collection, see Wu (1970).

⁴ Surprisingly, later, the "Liberated Areas" were the major producers and exporters of salt to the areas under Kuomintang control.

⁵ A tan, also called picul, equals approximately 60 kilograms.

clothing in the Border Areas in the late 1930s and early 1940s, Chairman Mao Zedong, in a speech delivered at a conference at the Shensi-Kansu-Ningxia Border Region in December 1942, stated:

“In the last five years, we have passed through several stages. Our worst difficulties occurred in 1940 and 1941 when the Kuomintang created friction with its two anti-Communist drives. For a time, we had a very acute scarcity of clothing, cooking oil, paper, vegetables, footwear for our soldiers, and winter bedding for our civilian personnel. The Kuomintang tried to strangle us by cutting off the funds due to us and imposing an economic blockade; we were indeed in dire straits. But we pulled through. Not only did the people of the Border Region provide us with grain but, in particular, we resolutely built up the public sector of our economy with our own hands. The government established many industries to meet the needs of the Border Region, the troops engaged in an extensive production campaign and expanded agriculture, industry, and commerce to supply their own needs, and the tens of thousands of people in the various organizations and schools also developed similar economic activities for their own support.” (Mao, 1942)

The Food Control Bureau and the Bureau for the Management of the National Economy

In addition to the financing arrangement discussed above, the Chinese Soviets had established the Food Control Bureau, which had the crucial tasks of accumulating reserved food, supplying rations to the Army, adjusting prices, and export control.

Furthermore, the cooperation of the Food Control Bureau, the External Trade Commission, and the Consumers Cooperative played a pivotal role in providing food to the Red Army and improving the people's economic condition in the Soviet Areas. One of the important functions of the Cooperatives was to produce agricultural products for export to the area under the control of Kuomintang. The earnings from exports made purchasing and importing manufactured products from the big cities under the control of Kuomintang possible.

Additionally, The Bureau for the Management of the National Economy, which played a significant role in the development of the economy of the Soviet Areas, was also established. The Resolutions of the Second National Congress of the Chinese Soviets, convened in January 1934, stated”... as a result of the establishment of the Bureau for the Management of the National Economy within the Soviet government, it has become possible to

direct economic construction in the Soviet Areas in a unified and planned manner.” (Miyashita, 1966, P. 20)

Money and Banking in the Chinese Soviets

The money and banking policies articulated in the Resolutions are not available in English for detailed discussions; however, Miyashita (1966) discusses the following policies.

1. Since many currencies circulated in the Soviet areas, all currencies were at par. All currencies circulating in the areas were stamped for ease of supervision. Moreover, the Soviet governments were permitted to issue their currencies and exchange them for currencies from outside the Soviet areas or with stamped currencies, as well as the Chinese old currencies in circulation.

2. To facilitate financial transactions and control the money supply, the Soviet government established the Workers' and Peasants' Bank (WPB) and authorized the Bank to issue its currency. Furthermore, the Soviet government mandated that WPB establish branches in each Soviet area and prudently provide credit to peasants, handicraftsmen, small merchants, and cooperatives to facilitate the production and exchange of products. Additionally, WPB was tasked with tax collection in their operated area and permitted to exchange currencies in circulation.

3. The existing large, private banks were prohibited from issuing currencies. Moreover, their operations were to be supervised, and their books were to be audited by WPB.

4. Trades with entities outside the Soviet areas under the strict supervision of the Soviet State Foreign Trade Commission were permitted, but monopolizing external trade was forbidden. Additionally, the export of silver from the Soviet areas was prohibited.

The metallic (silver) money, considered “hard” money, was to be issued by the Central Government of the Chinese Soviets and the Finance Departments of the Provincial Soviet Governments. The paper currency was to be issued by the Chinese Soviet Republic National Bank or the provincial banks with authorization from the Central Government of the Chinese

Soviets and the Finance Department of the Provincial Soviets under strict regulation of Soviet Banks⁶.

Starting in the Spring of 1933, the merchants from the Kuomintang areas had to exchange their Kuomintang-issued money with Soviet-issued-money. The money from the Kuomintang area was deposited in government banks, and trade organs in the Soviet areas had to purchase goods from Kuomintang-controlled regions.

Kuomintang-CPC Agreement and Issuing of Border Currency

After Japan's second invasion of China in 1937, the CPC and the Kuomintang signed the Peace Agreement. One of the terms in the Agreement was Kuomintang's recognition of the People's Liberation Army. After signing the Agreement, the PLA changed its name to the National Revolutionary Eight Route Army. Moreover, recognizing the authority of the central Kuomintang government, the CPC declared it had abolished the Chinese Soviet governments and established a Special Area Government. Over time, however, the CPC, instead of using the name "Special Area," used "Border Area."

Moreover, because of changing military conditions, the Chinese Soviets were in a continuous state of flux. In the final analysis, by 1941, there were 18 Border Areas. Because of geographical isolation and the changing military situation, each Border Area was economically isolated and independent of the Kuomintang government's monetary system.

The first Border currency was issued on 20 March 1938 in the Chin-Ch'a-Chi Border Area at the exchange rate of 1 yuan of Chin-Ch'a-Chi Border currency, equal to 1 yuan of Kuomintang Legal Tender Notes. Moreover, starting on 1 October 1941, circulation of Kuomintang Notes in the Border Area was prohibited. Seven Border Areas currencies were issued from March 1938 until WWII ended in March 1938, October 1939, May 1940, February 1941, and April 1942. Moreover, four currencies were circulated in the Liberated Areas from August 1945 until September 1949. Additionally, currencies issued by the Trading Companies and the PLA circulated in the Areas (Miyashita, 1966, pp. 49-50).

⁶ The Chinese Soviet Republic National Bank opened on 1 February 1932 in Tungku and opened branches in many other Soviet areas.

Decentralized Monetary System in the Border Area

One of the goals of the decentralized monetary system established in the areas controlled by the CPC was the management of the ongoing currency wars between the three contending powers: Japan, the Kuomintang, and the CPC. Moreover, the decentralized monetary system was a prudent policy to prevent the collapse of the monetary system in the Border or Liberated areas in case of the loss of one of the territories by the PLA to the opposing armies.

Each Border Area commercial bank that issued currency waged a “currency war” against the currencies in circulation in the areas controlled by Kuomintang and the Japanese. The Trading Companies and cooperative stores also issued the same currency issued by the bank in the area. The currencies issued by banks, Trading Companies, and cooperatives were known as “Border Currency”, “Border Notes,” or “Resistance Currency”. However, after the defeat of Japan, Japan surrendered to the Kuomintang authorities, and the PLA became stronger compared to its strength during WWII. Moreover, the CPC consolidated and unified the Border Areas; the consolidated regions became known as “Liberated Areas”, and the currencies in circulation in the Border Areas were integrated into the form of the People's Currency or the renminbi. (Miyashita, 1966).

Financial Condition and Inflation in the Border Area: 1938-1949

After the Japanese second invasion of China in 1937, three factors contributed to financial panic and inflation in the territories under Chinese control. These included increases in the prices of the metals used in minting coins (*e.g.*, copper and nickel), which increased the price of the metal contained in the coins in circulation to be more than the face value of the coins. The result was the disappearance of metallic money from circulation, thus lowering the size of the money supply to the economy. Secondly, the traditional trade based on credit was replaced by cash payment for purchasing goods and services after the renewed Japanese War on China. The third factor was the use of the Border Area's money and commodities as the objects of speculation by the speculators.

Profiteering in Staple Food Market

As early as 1933, the leaders of the CPC were concerned about merchants buying farm products from the peasants at low prices and then selling them

in city markets at much higher prices. In a speech delivered at the economic construction conference of seventeen counties in southern Kiangsi in August 1933, Mao Zedong discussed the problem:

“Judged by volume, grain ranks first among the principal outgoing commodities in our trade with the outside areas. About three million piculs of unhusked rice are sent out yearly in exchange for necessary consumer goods, or an average of one picul a head of the three million population; it cannot, surely, be less than this. But who is handling this trade? It is handled entirely by the merchants who exploit us ruthlessly in the process. Last year they bought unhusked rice from the peasants in Wanan and Taiho Counties at fifty cents a picul and sold it in Kanchow for four yuan, making a sevenfold profit. Take another instance. Every year our three million people need about nine-million-yuan worth of salt and six-million-yuan worth of cotton cloth. Needless to say, this fifteen-million-yuan trade in salt and cloth has been entirely in the hands of the merchants; we have done nothing about it. The exploitation by the merchants is really enormous. For instance, they go to Meihsien and buy salt at one yuan for seven catties, and then sell it in our areas at one yuan for twelve ounces. Is this not shocking profiteering? We can no longer ignore such a state of affairs, and from now on we must handle this trade ourselves. Our department of trade with outside areas must make a great effort in this connection.” (Mao, 1933).

Regarding the significance of the salt trade that Mao mentioned in his speech, salt was a significant means of payment for the people in the Border areas. They exchanged salt for manufactured goods in their trade with the merchants in the regions controlled by Kuomintang. The following quotation shows the significance of salt trade in the economy of the Border Area:

“...the production of salt was one of the greatest sources of wealth in the Border Area and was of radical importance in achieving a balance between imports and exports, in maintaining the stability of currency and credit, and in adjusting prices. The greater part of the people exchanged salt for goods produced outside the Border Area, and a considerable proportion of the Army and the Party workers maintained or supplemented their livelihood using salt.” (Miyashita, 1966, p. 39)

Inflation in the Border Areas

The Border Area's government budget deficits and the military pressure and encirclement by the Japanese, as well as Kuomintang armies, caused an inflationary dynamic in the Area. It is estimated that during three years beginning in February 1941 and autumn of 1944, “..the value of Border