



# Price Stability and Development in Mainland China (1951-63)

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# PRICE STABILITY AND DEVELOPMENT IN MAINLAND CHINA (1951-63)<sup>1</sup>

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## I. INTRODUCTION

CONTROLLING inflation in any underdeveloped economy where the emphasis is on rapid economic growth is never easy. Policies for controlling price increases almost invariably affect a country's rate of growth—a fact no less true for Mainland China than for any other developing country. The particular interest of the Chinese Communist experience arises from the high degree of direct control exercised over most aspects of the Chinese economy. This high degree of control has often forced the regime to face the relationship between inflation and growth in areas where the connection between the two is commonly ignored.

Until 1958 or 1959 the Communists in China had managed not only to achieve a high rate of growth, but to keep price increases at a moderate level. They accomplished this in the face of a development strategy that gave overwhelming priority to the industrial producers' goods sector and a technique of planning that relied on overfull utilization of resources. In addition, during the first three years of the regime's existence, China was involved in a major war effort. Under similar, but probably less severe, handicaps the Soviet Union in

the 1930's had found it necessary to allow a substantial inflation in prices.

This paper attempts to deal first with the question whether the absence of increases in the official price indexes is meaningful, or simply the result of statistical inadequacies or the arbitrary freezing of prices combined with extensive rationing and black markets. Second, I discuss the extent to which this stability has been achieved by direct controls over the flows of purchasing power onto the consumers' goods market and analyze the methods used to close the inflationary gap where such direct controls have proved inadequate. Finally, I attempt to appraise whether, given the goals of the Chinese Communists, the selection of alternative anti-inflationary measures has been made in the most efficient manner.

The main focus is on retail prices and the consumers' goods market because this was where the regime's major efforts were directed. The Soviet system in industry, of centrally planning and allocating most important raw materials and producers' goods, was initially taken over almost *in toto* by the Chinese Communists. It made the freezing of wholesale prices both easy and, from the point of view of simplifying the task of planning, desirable. Retail prices, however, could not be held down for any length of time without concurrent control of the sources of purchasing power entering the consumers' goods market, or the result

<sup>1</sup> This research was carried out at Harvard University and in Hong Kong under a grant from the Ford Foundation Foreign Area Training Fellowship program. The author's principal debts for advice and criticism are to Professors Abram Bergson and Simon Kuznets.

would have been widespread rationing, a black market, or both.

## II. EXTENT OF INFLATION SINCE 1951 AND ITS SIGNIFICANCE

The major sources of information on price increases are the official retail price indexes published by the Communists. These show an average annual rate of increase since 1951<sup>2</sup> of barely 1 per cent with the largest rises being only 3 and 2 per cent in 1953 and 1957, respectively (see Table 1). Although the last date for

ity of the regime to collect adequate nationwide price data for any but a few dozen major consumer items—commodities that were either formally rationed or at least had their prices held below what they would have been on a completely free market. The remaining commodities, the ones that were not generally included in the indexes, not only were not subject to such rigid price control, but had, in addition, to soak up the excess purchasing power that normally would have been soaked up by the major com-

TABLE 1  
PRICE INDEXES OF CONSUMERS' GOODS IN CHINA  
(1952 = 100)

Year	All-China Retail Price Index	Rural Retail Price Index	Price Index of Industrial Products in Rural Areas	Retail Prices in Eight Large Cities
1951.....	100.1	.....	100.5	101.0
1952.....	100.0	100.0	100.0	100.0
1953.....	103.2	100.9	98.5	104.9
1954.....	105.5	104.5	100.2	106.9
1955.....	106.3	105.7	101.4	107.9
1956.....	106.3	105.3	100.4	107.8
1957.....	108.6	107.7	101.6	109.1
1958*.....	108.3	107.1	101.0	108.2

\* First half of year.

Sources: State Statistical Bureau, *Ten Great Years*, pp. 172-74, and Hong Kong, *Wen Hui Pao*, June 1, 1958.

which official price indexes were published was June, 1959, refugee and other firsthand evidence indicates that official prices have not risen significantly through 1962 and perhaps 1963.<sup>3</sup>

These indexes, however, do not completely reflect the true extent of price increases during the periods of greatest inflationary pressure, 1953, 1956, and 1960-62. This was a result of the inabil-

<sup>2</sup> The year 1951 was the first in which one can safely state that the hyperinflation of the 1940's had been brought completely under control.

<sup>3</sup> A number of official prices were raised in 1963, but not enough data are available to ascertain whether these increases had a significant effect on the indexes.

modities. These excluded commodities made up approximately 30 per cent of all retail sales<sup>4</sup> and were sold mostly on the free markets.

Evidence to support the belief that official price indexes tended to have a downward bias can be found for all three periods during which there were particularly severe inflationary pressures. For example, in 1953 the official prices of grain and cotton cloth hardly rose at all (the cotton-cloth price actually fell), but

<sup>4</sup> *T'ung-chi Kung-tso T'ung-hsun* ("Statistical Work Bulletin") data office, "The 1956 Domestic Market Price Situation," *Hsin-hua Pan-yueh-k'an*, No. 10 (May 25, 1957), p. 115.

some grain was being sold on the free market at 20–30 per cent above the official price. Urban vegetable prices (many of which did not enter the official indexes) were about 30 per cent above their 1952 level. In the second half of 1957, vegetable prices in the eight largest cities had risen by 17.9 per cent over what they had been in the first half of 1956.<sup>5</sup> This was a rise which might of itself have caused an additional 1 per cent increase in the retail price index, if all, instead of just a few, vegetable prices had not been excluded from the official indexes.<sup>6</sup> Finally, refugee evidence indicates that between 1960 and 1962 free- and black-market prices (it was not easy to distinguish between free and black markets at this time) were many times the official prices.<sup>7</sup> Under the assumption that all the non-included prices fluctuated as much as vegetable prices, the bias in the official indexes would be 9 per cent in 1953 and 5 per cent in 1957 and considerably more in 1960–62. Vegetable prices, however, tended to be erratic for reasons only partly connected with general inflationary pressures, so that this is probably an extreme assumption. It is more likely that the bias was seldom more than 3 or 4 per cent except perhaps during 1960–62. During periods of retrenchment, such as 1954 and 1957, the official indexes may even

have overstated the rise because official prices tended to be as inflexible downward as up. The combination of retrenchment and better harvests has also caused free-market prices in 1963 to fall from their crisis levels, although not yet all the way back to the official prices at which the same goods could be bought with ration coupons.<sup>8</sup> None of these qualifications, therefore, negates the basic contention that price increases in Communist China have, in fact, been quite modest.

One may question whether these relatively modest price increases, including those increases on the free market, adequately reflect the extent of inflationary pressure on China's consumers' goods market. Certainly rationing was widespread and became progressively more so. Formal rationing of a sort began as early as November, 1953, in conjunction with the introduction of compulsory farm delivery quotas. It gradually spread to the urban areas and an increasing number of commodities. In addition, during periods of tight supply there has been considerable queuing up to purchase commodities not subject to formal rationing. Even taking the existence of widespread rationing into account, however, one can still support the contention that the unfilled inflationary gap was relatively small. With the exception of short periods during 1955–56 and 1958–59, a free market has existed in Communist China onto which most of the excess purchasing power has flowed. Inflationary pressures, as a result, have generally manifested themselves in the form of price increases rather than

<sup>5</sup> These price data are taken from Young Po, "Planned Purchase and Planned Supply and the National Construction of Socialism," *Ching-chi Yen-chiu*, No. 1 (February, 1956), p. 38; and Peking *Ta Kung Pao*, September 24, 1957.

<sup>6</sup> Vegetables made up approximately 7 per cent of the total expenditure of the average urban worker. This estimate is derived from data in "On the Question of Industrial and Agricultural Standards of Living," *T'ung-chi Kung-tso*, No. 13 (July 14, 1957), p. 4; and Peking *Ta Kung Pao*, September 24, 1957.

<sup>7</sup> This is based on refugee interviews conducted by the author and others in Hong Kong in 1961 and 1962.

<sup>8</sup> "Food Supply Improved," *Far Eastern Economic Review*, XL (April 11, 1963), 55; "Back to Normal," *Far Eastern Economic Review*, XLI (August 15, 1963), 370; and "Press Communique of National People's Congress," *Peking Review*, No. 49 (December 6, 1963), p. 7.

through the accumulation of idle cash balances. The actual price level (including free-market prices), therefore, has been a meaningful indicator of the true degree of inflationary pressures (even though these pressures have not been fully reflected in the official indexes). Furthermore, controlling this inflationary pressure has had a considerable effect on the efficiency of distribution on the consumers' goods market. When control has been tight, only a few major commodities have been rationed, but, when it has been loose, the extent of formal and *de facto* rationing has expanded rapidly.

### III. CONTROLS OVER SOURCES OF PURCHASING POWER

The Chinese Communists have had two basic means at their disposal for maintaining a balance between aggregate supply and demand on the consumers' goods market. First, unlike their free-enterprise counterparts, they had a number of direct controls over the sources of purchasing power entering the consumers' goods market which could be manipulated in order to maintain a balance. Second, they had several devices that could be used to fill any inflationary gap which did appear. To understand how the first of these alternatives worked, it is necessary to look more closely into the exact nature of Mainland China's consumers' goods market.

The main characteristic of the consumers' goods market was that it was not one but two distinct markets, one in urban and one in rural areas. Rural money purchasing power was derived primarily from the sale of farm and handicraft products, and between 70 and 75 per cent of it was spent on industrial products.<sup>9</sup> Urban money purchasing power, on the other hand, mainly came from

the wages of urban employees and was expended on both agricultural and industrial products, the former accounting for approximately 70 per cent of the commodity outlay of the average worker.<sup>10</sup> Therefore, the stability of the urban consumers' goods market depended primarily on the conditions of food supply in the cities, whereas that of the rural market relied instead on the distribution of industrial products in the rural areas.

The extent to which activities on one market influenced those on the other was limited. State control of commerce, when combined with turnover and profits taxes, made it possible to determine urban sales prices of major agricultural products independently of their purchase prices. These taxes and controls prevented an increase in inflationary pressure in urban areas from automatically spilling over onto the rural market. The only loopholes were the urban free markets and black markets where peasants sold their produce directly. Price increases on these markets, therefore, led to commensurate increases in peasant incomes and purchasing power. Control of the general level of purchasing power and prices in one market, therefore, was not necessarily the same as control in the other.

The two principal sources of purchasing power over which the authorities exercised control were the urban wage bill and state and co-operative purchases of farm products. Unlike market economies where wages are usually influenced

<sup>9</sup> This is derived from data in Table 2 and *T'ung-chi Kung-tso* ("Statistical Work") data office, "Price Gaps between Industrial Products and Farm Products: Their Changes in Post Liberation Years," *T'ung-chi Kung-tso*, No. 17 (September 14, 1957), translated in *Extracts from China Mainland Magazines*, No. 104, p. 23.

<sup>10</sup> "On the Question of Industrial and Agricultural Standards of Living," *T'ung-chi Kung-tso*, No. 13 (July 14, 1957), p. 4.

only through the manipulation of general monetary and fiscal controls and occasional interference in the process of collective bargaining, control in China was exercised directly through the planning apparatus. Both the number of workers whom an individual enterprise could hire and the total amount of wages that it could pay out were determined by the central planning authorities in Peking. Theoretically this gave the regime all the control it needed over urban purchasing power, but, in fact, these controls were often evaded. The situation was least under control following political "rectification" campaigns such as in 1956 and 1958 when financial controls were held in disrepute by the economically unsophisticated party cadres (see Table 2). This led to a situation where state firms could obtain all the funds they could possibly use either by obtaining loans from the state bank or direct allocations from the budget, or by illegally taking funds designed for one purpose and transferring them for use elsewhere.<sup>11</sup>

In the Soviet Union a similar evasion of wage controls resulted from a provision in the regulations providing for a 10 per cent overexpenditure above that provided in the plan in any month following on one when no such outlay was made. This possibility of evasion was compounded by the fact that wage overexpenditures were allowed whenever the output plan was overfulfilled. These provisions together with the increasing shortage of industrial labor led in the 1930's to severe competition between firms for the existing supply. As a result, the rate of labor turnover was over 100

<sup>11</sup> The nature of Chinese Communist financial control over industry is discussed at length in my "Price Formation in Communist China" (unpublished Ph.D. dissertation, Harvard University, 1964), chaps. vi and vii.

per cent during most of the first five-year plan, average wages increased nearly six times and the total wage bill over fifteen times between 1928 and 1940, while real wages fell.<sup>12</sup>

In China, on the other hand, there has never been anything remotely close to a labor shortage. Even aside from possibly underemployed labor in the rural areas, there was always some unemployment in the cities which was constantly being replenished by rural emigration.<sup>13</sup> As a result, when given the opportunity, industrial firms did not raise wages, but hired far more unskilled labor than what had been authorized. There were substantial unplanned additions to the wage bill of this type in 1953, 1956, and 1958.<sup>14</sup> In practice wage controls could be re-established only by tightening up the general availability of funds to the individual firms. The ability of the state in Communist China to manipulate the size of the wage bill, therefore, was not so much greater than that of the government in free-enterprise economies.

In theory the Chinese authorities also could adjust wage rates so as to offset any excessive inflationary pressure. Actually wage rates could not be changed quickly and played too important a role in maintaining worker incentives to be tampered with. In fact, during the first few years

<sup>12</sup> F. Holzman, *Soviet Taxation* (Cambridge, Mass.: Harvard University Press, 1955), pp. 37, 39-40.

<sup>13</sup> Urban unemployment is discussed at greater length in Ishikawa Shigeru, *Chugoku Ni Okeru Shihon Chikuseki Kiko* (Tokyo: Iwanami Bookstore, 1950), pp. 44-47.

<sup>14</sup> *T'ung-chi Kung-tso T'ung-hsun* ("Statistical Work Bulletin") data office, "The 1956 Labor Wage Situation," *Hsin-hua Pan-yueh-k'an*, No. 10 (May 25, 1957), p. 116; and Po I-po, "Draft Plan for the Development of the National Economy" (February 3, 1958), *New China News Agency*, February 13, 1958, translated in *Current Background*, No. 494, pp. 1-27.

following the Communist takeover of the Mainland in 1949, when the inherited inflation of the Kuomintang had not been completely brought under control, workers were paid in work points, each work point being worth a certain quantity of several major consumers' goods. Payment in work points protected the workers from the inflation and helped maintain their incentives and loyalties, but it also eliminated any role for wage control

determined tended to make them rise faster than would have been the case on a free labor market. State enterprises did not feel the need for as many wage differentials as in fact existed, resulting in promotions not being made where individuals were clearly eligible for them.<sup>15</sup> The proper grading of personnel was, therefore, made an element of the major wage reform of 1956 with the result that promotions in that year were excessive

TABLE 2  
SOURCES OF PURCHASING POWER  
(Millions of *Yuan*)

Year	Total Purchasing Power (1 = 2 + 3 + 6)	Total Urban Wage Bill	Rural Purchasing Power (3 = 4 + other rural income)	Total Sales of Agricultural and Subsidiary Products (4 = 5 + free-market purchases)	State and Co-operative Purchases of Farm Products	Purchasing Power of Collective Units
1950.....	17,660	.....	9,500	8,000	780	.....
1951.....	22,080	.....	.....	10,500	2,500	.....
1952.....	27,600	6,700	16,500	12,970	5,630	.....
1953.....	33,120	8,800	.....	15,320	8,170	.....
1954.....	37,670	9,610	.....	17,360	12,070	.....
1955.....	40,240	10,000	.....	17,800	.....	.....
1956.....	46,500	13,600	24,500	18,400	13,300	7,440
1957.....	47,000	15,250	25,000	20,280	15,620	6,400
1958.....	54,800	.....	30,000	22,760	19,720	.....
1959.....	.....	.....	.....	29,180	.....	.....

Sources: Specific sources can be found in D. H. Perkins, "Price Formation in Communist China" (unpublished Ph.D. dissertation, Harvard University, 1964), p. 453.

in bringing about the inflation's end. At the time elimination of the role of wage control only constituted recognition of the obvious fact that the source of the inflation was the imbalance in the government budget arising from the inadequacy of the existing sources of revenue. The wage-point system was gradually abolished once the inflation had been brought under control.

There is also evidence to suggest that not only was it impossible to reduce wages to bring about a balance on the urban consumers' goods market, but that the principles upon which wages were

from the point of view of price stability. The policy of relating the increase in the over-all average rate to the increase in average productivity of labor also gave wage determination an upward bias.<sup>16</sup> The relevant concept for wages is the marginal, not the average, productivity of labor. With China's labor surplus it is doubtful that marginal productivity in-

<sup>15</sup> Speech by Ma Wen-jui in *Chung-hua Jen-min Kung-ho-kuo Ti-i-chieh Ch'uan-kuo Jen-min Tai-piao Ta-hui Ti-san-tz'u Hui-i Hui-k'an*, 1956, p. 733.

<sup>16</sup> Hsiao Kung-ju, "The Principle Underlying Wage Increases," *Hsueh-hsi*, No. 15 (August 3, 1957), translated in *Extracts from China Mainland Magazines*, No. 106, pp. 12-14.



creased at all. Average productivity, on the other hand, increased each year, if for no other reason than that, prior to 1958 at least, the average laborer had more capital to work with. Finally, the use of piece rates in setting wages often brought about an excessively rapid rise in labor payments because of difficulties entailed in keeping the piece rate schedules adjusted to rapid improvements in industrial technology.

From this discussion it should be apparent that, although the Chinese Communists had the legal authority to adjust the wage bill at will, so as to bring it in line with the supply of goods on the urban consumers' goods market, the best they could do in practice was to slow down its rate of increase. Even this amount of restraint was impossible during periods when political pressures made tight financial control an anathema. The need to expand the urban labor force and to keep worker incentives at a peak so as to maintain the rapid pace of industrial development made any greater restraint undesirable.

The regime's hypothetical authority to determine the amount of funds spent on the purchase of agricultural and subsidiary products was as great as in the case of wages, but in reality this authority was even more circumscribed. The need for rapidly increasing farm purchases in order to feed the growing urban population, to export to the Soviet bloc and elsewhere to pay for imports of vital industrial goods, and to provide consumers' goods industry with the bulk of its raw materials<sup>17</sup> meant that purchases had to be increased as much as peasant welfare and the need to maintain peasant

incentives could bear. Nor could purchase prices be freely adjusted since the regime used relative price changes to alter the emphasis placed on the different crops. In addition, an across-the-board price fall would have seriously affected peasant incentives and increased their resistance to the marketing of their produce. As a result, Communist policy was to freeze all purchase prices subject to state control and raise them only when it was desirable to especially encourage the production of a particular crop. As it was, purchase price increases for the purpose of increasing production alone brought about a 10 per cent increase in the overall purchase price index between 1954 and 1958. One should not be left with the impression, however, that state agricultural purchase policies contributed nothing to controlling inflation. The resale of these commodities on domestic retail markets soaked up several billion dollars of purchasing power more than their original purchase had created, because turnover and profits taxes raised the retail prices well above the prices at which the same goods were purchased without any comparable increase in commercial wages or costs. Reduction of state farm purchases, conversely, caused a net increase in inflationary pressure. Thus during the agricultural crisis from 1960 through the early part of 1962, the need to reduce state purchases increased inflationary pressure by a considerable extent and led to great increases in free- and black-market prices.

One possibility which might have introduced more flexibility into the control of inflationary pressures arising out of fluctuations in farm output and purchases would have been a compensatory agricultural tax. A progressive tax, however, would have had the maximum impact when it was needed least, and a re-

<sup>17</sup> Between 70 and 80 per cent of Chinese exports were agricultural or processed agricultural products and 70 per cent of the raw materials for consumers' goods industry were farm products.

gressive tax would have been an unbearable hardship and would certainly have tended to slow the development of agriculture. In actual practice the regime went to great lengths to insure that the agricultural tax would be as close to a fixed lump-sum tax as possible so that production would not be adversely influenced.<sup>18</sup>

The remaining sources of purchasing power were far less significant but more easily manipulated. The regime, for example, was able to control expenditure on consumers' goods by collective units. In 1957 the authorities reduced these groups' purchasing power by 17 per cent for the stated purpose of controlling the inflationary pressure then extant.<sup>19</sup> Unfortunately not very much is known about the nature of this source of purchasing power. It apparently includes funds of army units, welfare institutions, schools, etc. There is probably some minimum level below which expenditure in this area cannot be reduced, and it is possible that that minimum was nearly reached in 1957.

State agricultural credit could also be fairly easily manipulated in order to restrain inflationary pressures. The bulk of agricultural investment came from the savings of co-operatives and communes and not from the outside. State-supplied credit, therefore, could be cut back without seriously impairing rural investment programs. The level of such credit in 1953 and 1954 was too small<sup>20</sup> to make cutbacks of any great use, but by 1957 the amounts involved were substantial

enough to make reductions in rural credit an important element in the anti-inflationary policies of that year. Similar but probably even greater reductions in farm credit and direct budget allocations to the communes apparently were undertaken in 1960.<sup>21</sup>

Adjustments in the level of advance purchases of farm crops, a form of credit, were of little help in combating long run inflationary pressure since the government had to pay for the crops at the very latest when it actually received delivery; but they could be used as a device for shifting pressure to a period when the state was better able to handle the inflation by other techniques. Thus in 1957 these payments were reduced by 160 million *yuan*,<sup>22</sup> a move which probably shifted some pressure off the tight conditions of early 1957 and onto the latter half of the year (when most purchases were actually made), by which time the inflationary pressure had subsided. Except for 1960 when the potential for cutbacks in agricultural credit and allocations was so great, however, the largest reduction in purchasing power which could be culled from these various minor sources was less than two billion *yuan*, equivalent to only a 10 per cent increase in farm purchase prices or quotas or a 10–15 per cent increase in the wage bill.

<sup>20</sup> State-issued agricultural credit was 666 and 783 million *yuan* in 1953 and 1954, as compared to 3,029 million *yuan* in 1956 (Young Pei-hsin, "The Road to Raising the Agricultural Development Fund," *Ching-chi Yen-chiu*, No. 1 [January 17, 1958], p. 32).

<sup>21</sup> Agricultural credit in 1958 and 1959, which had gotten somewhat out of hand, totaled 9 billion *yuan*, and there were also large direct allocations of funds to the communes on a grant basis (Perkins, *op. cit.*, p. 142, nn. 55–56).

<sup>22</sup> *T'ung-chi Yen-chiu* ("Statistical Research") data office, "The Domestic Market Commodity Circulation Situation in 1957," *T'ung-chi Yen-chiu*, No. 4 (April 23, 1958), p. 24.

<sup>18</sup> The tax was a percentage of the "normal yield" of the land. This "normal yield" was held constant for a period of years.

<sup>19</sup> Huang K'o, "How We May Settle the Disequilibrium between Social Purchasing Power and the Supply Volume of Goods in 1958," *Chi-hua Ching-chi*, No. 11 (November 9, 1957), translated in *Extracts from China Mainland Magazines*, No. 119, p. 30.

The situation faced by the authorities until 1960, therefore, was one of substantial and largely unavoidable increases in both urban and rural money purchasing power. The importance of wages and farm purchase prices in maintaining worker and peasant incentives and determining cropping patterns transcended their role in controlling inflation. Compounding the difficulties facing the regime was the erratic way in which these increases occurred. Periodic wage reforms and changes in farm purchasing regulations and in the nature of the harvest made predictions of trends in purchasing power for even a year ahead of little use. Other sources of purchasing power such as that of collective units, farm credit, and the like, were more readily adjustable, but too small to offset fluctuations in the major components.

The problem for the authorities, as a result, was how to insure that consumers' goods production not only kept pace with the increase in purchasing power but grew at more or less the same rate as well. A rapidly increasing proportion of consumers' purchasing power, however, came from wages in the producers' goods sector which were only indirectly related to consumers' goods production. In addition, fluctuations in agricultural production were often not felt on the consumers' goods market until several months or a year later. There were, therefore, occasions when the supply and demand for consumers' goods were certain to be out of balance. The resulting gap had to be filled by means other than direct controls over the sources of purchasing power.

#### IV. CLOSING THE INFLATIONARY GAP

To retrieve this balance the authorities had either to find some means of

soaking up the excess purchasing power, or allow prices to rise at least temporarily. Chinese Communist resistance to the latter alternative was great, largely on political grounds. The Kuomintang hyperinflation of the 1940's had been a major factor in the alienation of the people and in the demoralization of the regime itself. The Communists, of course, exploited these feelings to the full and later pointed with pride to the speed with which they ended the rapid price rise. They oversold this point, not only to the general populace but, more importantly, to the lower level party cadres as well. It was this latter group that was charged with the responsibility for seeing to the proper functioning of the free markets and rural trade fairs. Because of their dislike of price increases, they commonly looked on their duties in this area as the curtailment of capitalist tendencies, that is, as the freezing of prices and the limiting of the scope of the market itself. The penchant for price-freezing and suspiciousness of free markets in general carried to some degree even up to the highest level of authority. Price rises were seldom consciously allowed for the purpose of bringing supply and demand on the consumers' goods market into balance except where a price increase might stimulate the increased production of some particularly scarce commodity.<sup>23</sup> Since the turnover and profits taxes kept price increases from affecting industrial consumers' goods production, the only area where such price changes could have any influence was in agriculture. Therefore, the only prices that were

<sup>23</sup> One of several exceptions to this rule was the 29 per cent increase in the price of woolens in 1957 which was made to end queuing up on the market and reduce domestic demand so as to increase exports—not to stimulate production (*Shanghai Chieh-fang Ch'ien-hou Wu-chia Tzu-liao Hui-pien* [Shanghai: People's Press, 1958], p. 435).

adjusted with any degree of regularity at all were those of crops and major farm subsidiary products.

It was not uncommon, as a result, for the regime to be faced with the task of closing an inflationary gap by some means other than allowing prices to rise. When the problem was minor or short run, the most obvious possibility was to allow commodity stockpiles to take up the slack. There were in fact considerable fluctuations in these stocks, but on the whole the stocks were much too small to make a significant difference. Chou En-lai and others called for a substantial increase in these reserves so as to ease the amount of disruption caused by temporary runs,<sup>24</sup> but the more common approach of those in power was to look on substantial reserves as evidence of waste and excess conservatism. In addition, there was the prevailing optimistic attitude that production on all fronts was bound to be much higher next year or the year after; hence why make people tighten their belts further now? Optimism about future development prevailed in 1956 when the cotton-cloth ration was first raised and then, after cotton output had not come up to expectations and reserves had been depleted, had to be cut in half.<sup>25</sup> The good harvest of 1958 was probably also, to a large degree, consumed immediately rather than set aside against future disasters.<sup>26</sup>

<sup>24</sup> Chou En-lai, "Report on the Proposals for the Second Five-Year Plan for Development of the National Economy," *Eighth National Congress of the Communist Party of China*, I, 277.

<sup>25</sup> Ministry of Commerce, "Report on the 1957 Supply of Cotton Cloth," *Jen-min Jih-pao*, April 20, 1957, translated in *Union Research Institute*, Vol. 7, No. 17.

<sup>26</sup> This statement is somewhat speculative. The lack of good data, particularly for agriculture in 1958 and 1959, makes it necessary to rely on a few scattered refugee reports.

The most important measure for closing the gap at least over the long run was, of course, consumer taxes. As in the Soviet Union, by far the most important of these taxes were those that could be classified under the general heading of sales taxes. In the case of China this would include the industrial and commercial taxes, which were similar to the Soviet turnover tax and tax on the profits of state enterprises.<sup>27</sup>

The importance of sales and profits taxes is readily apparent from the data in Table 3. The decision to put so much weight on taxes of this type was a clear case of development considerations taking priority over price stability. The high rate of investment, the emphasis on producers' goods, and the lack of foreign aid in any great quantity all meant that the tax burden on the consumer had to be extremely heavy. Considering the low level of per capita income in China, it was crucial that this heavy burden not damp incentives and thus slow development any more than was absolutely necessary. Other taxes might make possible a more flexible short-run response to fluctuations in inflationary pressure, but a sales tax could more easily disguise the true size of this development burden.

Sales taxes, however, could not stop an initial rise in prices, but could only prevent excess demand from increasing retained profits and eventually spilling onto the labor market, thus creating further inflationary pressures. The regime still had the problem of how to close short-run inflationary gaps if it wanted

<sup>27</sup> The difference between the industrial and commercial taxes and the profits tax (or revenue from state enterprises) was that the former was a fixed percentage of the price while the latter was a flexible percentage designed to cover whatever ground remained between a commodity's cost plus other taxes and its price. Both taxes fell on producers' as well as consumers' goods, but for different reasons not relevant to this paper.

to prevent prices from rising in the first place. One possibility still within the realm of taxation would have been to introduce an income tax. Unlike the Soviet Union, Communist China had no income tax at all, unless one includes the above-mentioned agricultural tax. During the first few years of Communist rule there were substantial levies on the income of capitalists, which had as one of their goals the control of inflationary pres-

large or sharply progressive to have much of a stabilizing effect.

To control short-run changes in inflationary pressure on the urban consumers' goods market, therefore, the regime had to rely on two other devices, namely savings deposits and bond sales. The two together accounted for over one billion *yuan* in purchasing power in each of the years 1954 through 1957 and 1959, and two billion *yuan* in 1958—about 10

TABLE 3  
REVENUE DATA AND THE BURDEN OF TAXATION  
(Millions of *Yuan*)

Year	Total Revenue (Excluding Revenue from Credits and Insurance)	Sales and Profits Taxes	Budget Surplus (+) or Deficit (-)	Revenue from Credits and Insurance	Burden of Money Taxes on Consumers	Per Cent of Money Income
1950.....	5,340	3,260	-1,470	330	2,943	16.7
1951.....	9,160	7,980	-1,050	570	6,620	30.0
1952.....	17,370	11,880	580	190	10,390	37.6
1953.....	21,270	15,920	- 220	490	12,753	38.5
1954.....	24,440	18,930	- 190	1,790	15,370	40.8
1955.....	24,840	19,920	-2,080	2,360	14,266	35.5
1956.....	28,020	23,520	-2,560	720	15,748	33.9
1957.....	30,320	25,725	1,300	700	16,670	35.5
1958.....	41,060	36,200	100	800	21,315	38.9
1959.....	54,160	49,060	2,150	0	.....	.....
1960 budget...	70,020	64,750	0	0	.....	.....

Sources: Perkins, *op. cit.*, pp. 417-19, and his "Chinese Communist Taxation" (in preparation). The data are from official Communist sources except for those on the burden of taxation which are estimates by the author and the total revenue figures for 1950 and 1951 which are derived from percentage increases in revenue published by Chinese official sources.

sures resulting from the Korean War. The main reason for these levies, however, was to help to squeeze the capitalists out of existence, a task largely completed by 1955 or 1956. A progressive tax on urban wages and salaries would have been administratively feasible, but the authorities undoubtedly felt that they could accomplish most of the same results by controlling wages and salaries directly and with a far smaller effect on incentives. Under the circumstances the maintenance of incentives was the more important goal, particularly since the income tax would have had to have been

per cent of the total wage bill in each year.

According to the regulations, savings deposits and bond purchases were to be voluntary, but in practice Communist cadres were able to bring considerable pressure to bear. Pressure, however, has not been the only technique used. Interest is paid on deposits and the regime has even resorted to holding raffles based on savings deposits. That such efforts probably met with some, although limited, success may be shown by the fact that current deposits increased from 19.1 per cent of individual deposits to 29.8 per

cent in 1956 after awards for such deposits were introduced, although the rise in income as a result of the 1956 wage reform was undoubtedly also a factor.<sup>28</sup> Nevertheless, it remains a fact that two of the largest increases in deposits, those of 1956 and from April, 1959 to July, 1960, took place after the issuance of major state council directives calling on the cadres to make greater efforts to "educate" the masses to make larger deposits.<sup>29</sup>

been to aid in soaking up the surplus funds of private capitalists. As industry and commerce were socialized, the state had to turn to other sources. In June, 1958, the decision was made not to issue any further national economic construction bonds starting in 1959 and local authorities were empowered to issue a limited amount of short-term bonds at a reduced rate of interest. The official reason given for this change was that the decentralization measures of 1958 made

TABLE 4

URBAN AND RURAL BANK DEPOSITS, BOND SALES, AND PURCHASES OF PRODUCERS' GOODS  
(Millions of *Yuan*)

Date	Urban Deposits in People's Bank (End of Year)	Net Annual Change	Bond Sales in Urban Areas	Rural Deposits	Rural Bond Sales	Sales of Producers' Goods to Agriculture
1950.....			242		18	730
1951.....						1,030
1952.....	740			121		1,410
1953.....	1,090	350		251		1,920
1954.....	1,290	200	694	362	140	2,500
1955.....	1,570	280	484		135	2,820
1956.....	2,230	660	469	799	138	3,700
1957.....	2,790	560	433	1,800	217	3,260
1958.....	4,000	1,210	470		320	6,680
April, 1959.....	3,800					
1959.....	5,123	1,023	0		0	8,100
1960 plan.....						11,000
July, 1960.....	5,749					

Sources: Perkins, *op. cit.*, p. 458.

The role of bond sales was somewhat different. Their original function had

<sup>28</sup> "A Survey of the Work of Savings during the First Five Year Plan Period," *Chung-kuo Chin-yun*, (March 7, 1958), translated in *Union Research Institute*, XI, 34.

<sup>29</sup> The former was issued on November 5, 1955, and was based on recommendations in People's Bank of China, "Report on Progress in Developing People's Deposits," *Chung-hua Jen-min Kung-ho-kuo Fa-kuei Hui-pien*, No. 2 (August 30, 1955), pp. 548-51. The latter was issued on June 5, 1959 (State Council, "Directive on Strengthening Leadership over Bank Deposit Work and Positively Developing People's Deposit Work," *Chung-hua Jen-min Kung-ho-kuo Fa-kuei Hui-pien*, No. 9 [June 5, 1959], pp. 137-40).

it necessary to increase the sources of revenue available to the local authorities,<sup>30</sup> but since most local governments in 1959 apparently decided not to issue any such bonds, there probably is a different explanation. It may be that the element of coercion in such bond sales to workers and peasants was so great that it took on the nature of a tax. Bank deposits could at least be redeemed if the individual was willing to go to the neces-

<sup>30</sup> *Jen-min Jih-pao* editorial, "Why We're Going To Issue Local Economic Construction Bonds," *Hsin-hua Pan-yueh-k'an*, No. 12 (June 25, 1958), pp. 91-92.

sary trouble. Hence their disincentive effects were undoubtedly less.

Control of short-run inflationary pressures in the rural areas also depended to some extent on the ability of cadres to increase savings deposits and bond sales (see Table 4), but the relative poverty of the rural population combined with the natural rural suspicion of such things as banks and bonds made these methods less useful than in the urban areas. More important was the state's ability to influence the rate of savings and investment in the rural areas through its control over agricultural co-operative and commune cadres. It was through these cadres that most of the funds from the sale of farm produce were channeled after 1955. This may partly explain the substantial increase in rural deposits which took place after 1956, although both the size and nature of these deposits is difficult to determine. The most significant result of the shift in control over funds to the cadres was the enhanced importance of the supply of producers' goods to agriculture. Since few of these commodities depended on agricultural raw materials, their production was comparatively easy to expand; and the party could see to it that there was no lack of sufficient demand. The fact that the state was reducing the prices of these items fairly regularly also increased their potential role as short run anti-inflationary devices. If the state felt that rural purchasing power was excessive at any particular time it could postpone these price reductions, thus soaking up additional purchasing power. Whether or not these prices were actually controlled for this purpose is difficult to say. What is certain is that the greatly increased delivery of producers' goods to agriculture was probably the main factor preventing excessive demand for consum-

ers' goods in rural areas. Even the increase in rural deposits, in fact, did not affect the total amount of purchasing power entering the market as much as it affected the shift in direction of that purchasing power from consumers' to producers' goods.<sup>31</sup>

#### V. SUMMARY AND APPRAISAL

The Chinese Communists were able to maintain a high degree of price stability in the face of rapidly increasing purchasing power and somewhat unstable production conditions, particularly in agriculture. Although some of this stability was bought at the cost of formal and *de facto* rationing, the lack of price increases in the main represented a degree of success in preventing the appearance of excess demand on the consumers' goods market. The absence of inflation was brought about by a combination of efforts designed to restrain increases in purchasing power and to fill any gaps which did appear.

The regime's emphasis on producers' goods industry and a high rate of investment created a large discrepancy between total purchasing power and the value of available consumers' goods when priced at factor cost. This long-run problem was solved primarily by the introduction of the sales tax—a device chosen because it tended to obscure the true tax burden. Increases in the gap between purchasing power and available goods were also prevented by maintaining as tight a rein as possible on the growth of the wage bill and on rises in agricultural purchase prices. Incentive and other developmental considerations, however, made some increases in wages and prices necessary. In addition, the

<sup>31</sup> Deposits in credit co-operatives were the main basis upon which loans were issued to peasants and co-operatives for productive purposes.

inflexibility of the sales tax and the erratic rates of increase in purchasing power meant that short-run inflationary gaps were continually reappearing. For political reasons, these gaps could not be closed by temporary price increases. As a result, they had to be filled by makeshift measures such as bond sales and savings deposit drives.

Two questions may be raised concerning these developments. First of all, if it was in fact necessary to hold prices down as rigidly as was the case in Communist China, did the regime go about controlling suppressed inflationary pressures in the most efficient manner? Second, was it really desirable to exercise such tight price control, or were the costs of the required measures greater than the benefits derived?

As to the first question, it is difficult to escape the conclusion that the situation, except perhaps during the "great leap forward," was handled about as well as it was reasonable to expect in light of the basic goals of the regime. Given the emphasis on rapid industrialization in the producers' goods sector and the erratic pace of development likely to occur in any ambitious country so inexperienced in planning and so dependent on agriculture, there were bound to be times when the amount of purchasing power entering the consumers' goods market did not match the supply of commodities available. The only real question, therefore, is whether, once inflationary pressure appeared, it was dealt with quickly and effectively. On the negative side there were few measures which could be classified as automatic stabilizers as that term is presently used in the United States. Only an agricultural crisis, because it led to reductions in purchases of agricultural products and eventually in urban employment, thus partially offset-

ting inflationary pressure deriving from the drop in supply of farm products, tended to adjust purchasing power automatically to meet the smaller amount of goods available on the market. As already explained, however, a reduction in purchases still had a substantial net inflationary effect, and offsetting reductions in urban employment were far from fully automatic. Individual enterprises could and often did keep on unnecessary workers long after their output had been curtailed. The graduated income tax, the most important single automatic stabilizer in the United States, would have been impossible in the rural areas and would have had too great an effect on incentives in the cities. Even savings deposits and bond sales in China did not primarily respond to changes in the level of income.

As a result, the central authorities had to rely mainly on timely administrative action in the form of direct adjustments of the sources of purchasing power or intensified savings deposit drives. With the possible exception of savings deposits, however, these various measures also played important roles in promoting economic development, roles which usually had a higher priority than the control of inflation on the consumers' goods market.

The lack of automaticity also meant that the regime had to recognize the existence of difficulties and then to take action. In theory there should have been no difficulty in recognizing inflationary pressure because the state directly controlled most of the relevant elements and determined them according to the needs of the national plan, but the crude state in which planning still operated made recognition in reality a complicated task. In 1953 and 1956 the regime was aware fairly promptly of the inflationary pres-



sure since price increases on the free market and runs on commodity stores were difficult to ignore. In late 1958 and early 1959 the authorities also seem to have realized that some pressure existed, but tight price control and the spirit of the period eschewed frankness on the part of lower-level cadres which may well have delayed the regime's recognition of the true situation.

Once the existence of pressure was recognized, there were further unavoidable lags before the required policies could be decided and acted upon. The Chinese Communists may not have had to worry about what a recalcitrant Congress might say, but the measures available to them could not be manipulated rapidly at will without seriously impairing production and development. Even bank deposits could not be too speedily pushed unless the regime were willing to eliminate all pretense of voluntariness—in which case they might as well have had an income tax. That the lag involved can be substantial is evidenced by the fact that the top leadership was uniformly aware of the inflationary pressures of 1956–57 by the time of the Eighth Party Congress in September, 1956, and had already called for action to be taken; but the pressure did not subside until late 1957, reaching a peak in early 1957—six months after the meeting of the Party Congress. This lag was partly due to the fact that budget cutbacks had to await the introduction of the new budget if they were to be accomplished systematically, and partly due to the fact that many of the policies affected consumer purchasing power only indirectly.<sup>32</sup> The corresponding lag during the 1958–59 “great leap forward” was, if anything, greater than in 1956–57 if for no other reason than that the greater the inflationary gap in the first place the longer

it is likely to take to eliminate it. One can argue for the 1958–59 case that the regime had the power to control the pressure on the consumers' market more efficiently by planning as well as it was capable in the first place, but careful planning, whether for better or for worse, would have interfered with the basic idea of the “great leap,” which was to decentralize virtually all authority to the lowest-level industrial and agricultural units.<sup>33</sup> If one accepts the Chinese Communists' basic goals, therefore, they were about as efficient in handling inflationary pressure as was possible under the circumstances. Certainly their performance was more impressive than that of the Soviet Union in the 1930's, although part of the credit for this must go to the differences between the two countries' labor markets.

As for the second question—whether or not such rigid price control was desirable—it can be stated first that insofar as control was exercised indirectly rather than by administratively freezing prices it was undoubtedly a good thing. Inflationary financing of government investment in industry would have made no sense, since all the funds that could feasibly be taken from the population could be secured from the turnover and profits taxes. The people were probably far less aware of the true extent to which they

<sup>32</sup> E.g., cutbacks in investment only affected the consumers' goods market when they actually resulted in the termination of employment of workers employed on the various projects. Increases in bank deposits may have often merely been temporarily substituted for other methods of holding the idle cash.

<sup>33</sup> This is discussed at greater length in my “Centralization versus Decentralization in Mainland China and the Soviet Union,” *Annals of the American Academy of Political and Social Science*, September, 1963; and my “Centralization and Decentralization in Mainland China's Agriculture, 1949–1962,” *Quarterly Journal of Economics*, May, 1964.

were paying these taxes, and hence their incentives were affected less than if a substantial part of the investment funds had been provided by simply printing the necessary amounts of money. The experience with the hyperinflation of the 1940's insured that the Chinese people's incentives would be adversely affected to a significant degree at the first sign of a recurrence of inflation. Furthermore, the nature of managerial personnel in government enterprises was such that they tended to ignore financial considerations and often planning in general except when funds were tight.<sup>34</sup> In theory it was, of course, possible to divorce tight financial control over industry from inflation controls on the consumers' goods market, but in practice, as shown above, the former was necessary in order for the latter to be effective. Of all the control measures available to the Chinese Communists, only the savings-deposit drives and bond sales could conceivably be said to have had enough of a negative effect on incentives to outweigh their usefulness in controlling inflation or in accomplishing other objectives. The authorities themselves apparently came to this conclusion about bond sales, whereas

savings-deposit drives could be justified on the grounds that they were the only device available, except for allowing prices to rise, which could offset temporary imbalances on the market.

The more important question, however, is whether it was desirable to adopt such a policy of inflexible opposition to almost all price increases even when this involved direct as well as indirect price controls, particularly since direct controls made widespread formal and *de facto* rationing unavoidable. The gains from rigid direct price control were increased equity in the distribution of some major consumers' goods (only those which were formally rationed) and the minimization of political dissatisfaction arising from price increases in basic consumer items, a not insignificant factor in a country where the bulk of the population is not far above the subsistence level. On the negative side, *de facto* rationing in the form of long queues was both inefficient and inequitable. In the latter case, therefore, it can be argued rigid price control by the Chinese Communists was excessive even in the light of their own political and economic objectives.

<sup>34</sup> See n. 9.