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Great Leap Outward?

In this momentous opening week of 1979, the world's most populous nation and its most economically-advanced nation have reopened diplomatic relations after a break lasting a full generation. With this and a number of other economic and political initiatives, China has thrown open its door to the West in a sudden flurry of modernization. The suddenness of the shift brings to mind the Great Leap Forward campaign of the late 1950's, when Chairman Mao announced that China would achieve economic power overnight through self-sufficient means. The results are likely to be quite different this time, however. Instead of being burdened with a surplus of backyard steel smelters, as in the 1950's, China today seems more likely to reach its industrialization goal and to gain a growing role in the integrated world economy.

Modernization is the key word that captures the spirit of China's current policy. Its political leaders have recognized and publicized the backward state of the nation's economy, as a means of bringing about desired reforms. (In connection with Vice Premier Teng's visit to Japan last October, the Chinese TV network provided pictures, for the first time, of modern Japanese factories and prosperous Japanese consumers.) China's most popular slogan today is the "Four Modernizations" — in agriculture, industry, defense, and science — a slogan designed to symbolize the nation's goal of catching up with the major industrial nations by the year 2000. In all four areas, modernization means importing more goods and more knowledge from the outside world.

Planning for modernization

Last March, the Fifth National People's Congress approved a ten-year (1976-85) economic development plan, which called for the completion of 120 large industrial and infrastructural projects over this period. The plan envisages an annual 10-percent growth of industrial production, along with annual growth of 4 percent or more in agricultural production. Success of course is not certain, because of admittedly low worker morale and inefficient management practices. The President of the Chinese Academy of Social Sciences recently wrote that almost the entire growth in industrial production in the last two decades has been due to an expanded workforce, with labor productivity remaining virtually stagnant since 1958 — ironically, the period of the Great Leap Forward.

As a means of stimulating improved productivity, the nation's economic planners last year granted a 15-percent wage increase (the first since 1962) to about three-fifths of the entire nonfarm workforce. In addition, they initiated monthly incentive-bonus schemes in different localities to reward production units and individuals that fulfilled or overfulfilled their production quotas — and also delegated greater responsibility to provincial and local officials for promoting exports and foreign tourism.

Trade with the world

The ten-year plan envisages a massive increase of imports of capital and other goods from the industrial nations. This suggests a substantial increase in China's foreign trade, which for a country of that size has been surprisingly small. Despite

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a population of considerably more than 800 million people, China's total trade (exports plus imports) amounted to only \$14 billion in 1977. In striking contrast, Taiwan (population: 16 million) had \$18 billion in total trade; South Korea (population: 36 million) had \$21 billion; and Japan (population: 114 million) had \$141 billion in trade.

China's trade patterns have resembled those of a typical underdeveloped nation, with farm products and textiles accounting for more than half of all exports, and steel products and machinery accounting for more than half of all imports. This pattern may continue for some time to come, but with greatly increased volumes. Between 1977 and 1978 alone, China's total trade increased by half, to about \$20 billion.

China's giant import program in 1978 ranged from arms, aircraft, wheat, steel-making plants, petrochemicals, mining equipment, to oil rigs. Last February, China signed a bilateral trade agreement with Japan, its largest trading partner, which provided for an extra \$20 billion in goods to be traded over the next eight years in addition to normal trade flows. Within six months of that agreement, however, China had already ordered \$5 billion worth of Japanese goods and was negotiating for \$5 billion more. In April, China and the European Economic Community signed a five-year trade agreement, and this was followed by a large number of exchanges of trade missions and a large number of deal-signings with various European producers. Altogether, import commitments signed or under negotiation last year totalled roughly \$60 billion — almost ten times the previous year's import volume.

Trade with the U.S.

Because of the lack of political relations, China in the past has generally kept direct trade with the U.S. to a minimum, even at the expense of paying higher costs by purchasing through third countries. There was a flurry of interest after President Nixon's visit to China in the early 1970's, but trade generally languished thereafter except for heavy wheat purchases in the 1973-74 period of crop failures. Between 1977 and 1978, however, total two-way trade jumped from \$375 million to more than \$1 billion, exceeding the previous (1974) peak.

American firms concluded a number of trade and investment deals with Chinese officials during 1978. Intercontinental Hotels signed a \$500-million agreement to build a chain of at least five or six 1,000-room hotels; Kaiser Engineers won a contract to develop two iron-ore mines; Boeing sold three 747 jumbo jets; and IBM and Sperry Rand both sold some computers. Two U.S. textile firms agreed to supply textile machinery and raw materials to Chinese plants, with payment to be made in the form of finished textile products. Similar deals are being discussed in the metals, electronics, foodstuffs, and construction-materials industries. Also, five U.S. oil companies have been discussing joint exploration and development of China's offshore oil fields under product-sharing arrangements.

Paying for the future

China has reversed her earlier policy of self-sufficiency, whereby import trade was limited to the amount that current exports could pay for. How then can today's massive buying spree be financed? The current level of exports

obviously will not be sufficient, although trade surpluses of over \$1 billion were recorded both in 1976 and 1977. In fact, the trade accounts should show a large deficit for 1978 and many years to come. China can draw on her foreign-exchange reserves, variously estimated to range between \$2 billion and \$4 billion, but those reserves are small compared to today's level of purchases.

Despite ideological preferences, China has relied heavily on international credit in recent years, specifically in the form of deferred import payments — typically 15 percent down upon contract signing, 15 percent upon delivery, and the rest paid over three to five years. According to the National Council for U.S.-China Trade, China purchased a total of \$2.5 billion in turn-key plants (complete industrial plants) from Japan, the U.S. and the European Community in the 1973-77 period — and financed roughly one-half through deferred-payment schemes, one-third through progress-payment arrangements, and the rest through cash and other means. According to one estimate, China's external debt may rise from the recent level of \$2 billion to \$6 billion by the end of 1982.

China's debt-service ratio has varied considerably in recent years, but in 1977 only about 11 percent of her export earnings had to be allocated to pay off foreign financial obligations. On the basis of its good debt-servicing record, China is generally considered a good international risk. In fact, international bankers are more than anxious to cultivate business with China today, because of the slow business-loan demand and high liquidity conditions in most of the world's financial markets. The most recent example was last month's credit

agreement between China and ten British banks, which will make \$1.2 billion in credits available at 7¼ percent interest over a five-year period, with 85 percent of the value of the contracts guaranteed by a British-government agency.

With the adoption this week of formal diplomatic relationships, broader Sino-American economic relationships seem almost certain to follow. Some important obstacles still remain in the way, especially the issue of frozen assets. During the Korean War, the U.S. froze about \$75 million of Chinese funds, mostly in U.S. bank accounts, and China in retaliation seized about \$196 million of American assets. Until this issue is settled, China cannot leave any assets in this country, because they might be seized through court action by claimants of the seized U.S. assets in China. Other economic and political issues also remain to be solved, but over time, it seems likely that in its modernization drive, the world's most populous country will turn increasingly for help to the world's most economically advanced country.

Hang-Sheng Cheng

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/20/78	Change from 12/13/78	Change from year ago	
			Dollar	Percent
Loans (gross, adjusted) and investments*	124,146	991	17,241	16.13
Loans (gross, adjusted) — total	100,911	1,054	18,546	22.52
Security loans	2,127	227	3	0.14
Commercial and industrial	29,081	292	3,771	14.90
Real estate	35,225	195	8,021	29.48
Consumer instalment	18,911	136	4,404	30.36
U.S. Treasury securities	8,408	5	1,223	12.70
Other securities	14,827	68	82	0.55
Deposits (less cash items) — total*	117,688	42	13,452	12.91
Demand deposits (adjusted)	31,846	427	2,607	8.92
U.S. Government deposits	596	298	78	11.57
Time deposits — total*	83,127	225	10,709	14.79
States and political subdivisions	7,167	11	583	8.85
Savings deposits	31,214	61	72	0.23
Other time deposits†	42,252	154	10,583	33.42
Large negotiable CD's	20,482	166	5,957	41.01

Weekly Averages of Daily Figures	Week ended 12/20/78	Week ended 12/13/78	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves(+)/Deficiency (-)	+ 38	+ 47	+ 66
Borrowings	- 13	- 6	- 53
Net free(+)/Net borrowed (-)	+ 25	+ 41	+ 13
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales (-)	+ 721	+ 843	+ 1,549
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (-)	+ 398	+ 960	+ 593

*Includes items not shown separately. †Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . .

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