

Central Intelligence Agency



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DIRECTORATE OF INTELLIGENCE /

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China: The Year in Review

Summary

China's economic situation has continued to improve and its links with the outside world have been strengthened since the Third Session of the US-China Joint Economic Committee in December 1982. Political and economic relations with the United States have improved markedly. China has made some progress in reducing tension and increasing trade with the USSR; but fundamental differences still divide the two states. Persistent weaknesses in the economy and slow progress in domestic political reform remain chronic problems for the leadership; however, we do not believe these will hazard US efforts to forge closer economic relationships with China. [redacted]

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Domestic Politics

Deng Xiaoping and his supporters continue to attempt to streamline government and party organs--replacing excess or incompetent personnel, as well as those who continue to resist party policy, with younger and better educated officials and cadre. The restructuring has been carried out with moderate success at the upper levels of central and provincial government. It has yet to have much impact at lower levels. [redacted]

The next step in Deng's reform program is the current party rectification program, which began late last year and is aimed at improving Dengist control of the party and the party's domestic [redacted]

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This memorandum was produced by the China Division of the Office of East Asian Analysis in response to a Treasury Department request. Questions and comments are welcome and should be directed to the Chief of the China Division [redacted]

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image. The program is intended to rid the party of "leftists," mainly people who were particularly guilty of excesses during the Cultural Revolution; diehard opponents of the reform policies of the past several years also fall into this category. Rectification is also aimed at rooting out the most obvious--or least protected--of the large number of corrupt party members. The leadership knows that the party's image is badly tarnished and that a major cause is the cronyism, trading of favors, and outright graft common at all levels of the party. Propaganda attacking these practices has been unremitting. [redacted]

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Although many of Deng's reforms move the party in more liberal directions, there is little toleration of serious opposition or deviation from the approved line in either the policy or ideological sphere, or even in social behavior. The recent campaigns against spiritual pollution and crime, and the limits the party has increasingly set on individual action, make this abundantly clear. [redacted]

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We believe the top leadership is in general agreement over the goals and most of the tactics of the Dengist group. There are those who believe Deng has gone too far in some directions, especially in decentralizing authority and deemphasizing ideology, but the opposition is scattered and disorganized. At most it can only delay or water down some programs. [redacted]

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More serious is opposition and obstructionism at lower levels, where programs actually have to be implemented. In our judgment, attempts to deal with this problem will be only moderately successful, and lower-level opposition to many programs will dilute their effectiveness. We suspect this will be more a political than an economic problem. In economics, many measures favored by the top leaders are also very popular with the common people, while the party rank and file oppose them. This difference holds the potential for further estranging the party from the people at local levels. [redacted]

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China's collegial leadership, led by Deng Xiaoping, appears stable despite scattered reports of disputes over ideological, economic, and personnel issues. Deng's chosen successor, General Secretary Hu Yaobang, was the target of increased criticism late last year for ideological errors and for his leadership style. Hu has weathered the storm but his leadership credentials were somewhat damaged. The succession question is clouded by the unwillingness of the party elders to retire gracefully. If the 79-year-old Deng were to die in the near future, Hu would still have to share power with one or more party veterans. [redacted]

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Domestic Economic Policy

A major factor in the maintenance of power by Deng Xiaoping and the leaders around him has been the aura of success generated by their economic policies of the past four years. Overall growth has averaged over 5 percent per year during the period,

and personal consumption and the quality of life in both urban and rural China have steadily improved. Increases in the quantity and variety of food supplies and clothing, as well as badly needed additions to housing, now seem to be an important source of popular support for the leadership. [REDACTED]

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The Chinese economy nevertheless still suffers from the aftereffects of two decades of mismanagement. Efforts to revitalize economy have been hampered by the need to confront threats to basic economic stability, such as inflation, unemployment, and budget deficits. Beijing has been particularly frustrated by its inability to get industrial managers to improve quality, eliminate waste, and cut costs. Moreover, management reforms aimed at reducing costs have interfered with urgently needed energy and transportation projects. Enterprises have used retained profits to expand their facilities unnecessarily, using cement, steel and other construction materials needed by high-priority infrastructure projects. Currently, Beijing has adopted a more cautious approach to management reform, making only minor policy changes to deal with immediate problems. Chinese planners have said that further systemic reforms--including reform of a price system that now leads to inefficient allocations of resources--will have to wait until at least 1985. [REDACTED]

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The Chinese economic policymaking process has become more orderly and policies are more practical and growth-oriented. Over the past year, Beijing has also experimented with Western demand-management policies. The banking system has been restructured to make monetary policy a viable option and fiscal tools have been put into use. The Sixth Five Year Plan (1981-85), approved in late 1982, provides a reasonably well-defined policy framework and aims at establishing the foundation for more rapid growth in the 1990s. A number of the Plan's relatively moderate targets were fulfilled in 1983, two years early. Others, such as those for energy, may be difficult to achieve. Problems of addressing these imbalances in sectoral growth may in part be responsible for the current delay in publication of the national budget and annual plan for 1984. [REDACTED]

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Over the longer term, we suspect that the good economic performance of the past few years will be far more difficult to sustain. The deficiencies of the overworked transport system will take years to remedy, as will expanding China's capacity to produce energy and get it to where it is needed. Shortages of scientists, engineers, and technicians will ease slowly unless Beijing undertakes a more rapid expansion of educational facilities than is now planned. China's attempts to limit population growth, particularly in the rural areas, are also not proceeding well. This suggests that the increasing pressure of population on food supplies, housing, and other resources will become a major constraint on sustained and balanced economic growth in the late 1980s and 1990s. [REDACTED]

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Foreign Economic Policy

Over the past year, Beijing has continued to enlarge the "open door" to foreign participation in the economy. Although the spiritual pollution campaign--the attack on undesirable cultural influences resulting from increased contacts with the West--holds a potential for limiting foreign activity in China, the leadership so far has been careful to insulate economic matters from its effects. The leadership thus continues to expand China's foreign trade and to emphasize foreign investment and the import of foreign technology. [redacted]

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For the second consecutive year, recession and growing protectionism in the developed West slowed the growth of China's exports. Exports totaled \$24 billion in 1983, up only 2 percent from the level of 1982. Declining exports to the West led China to open up new markets in the Middle East, Eastern Europe, and the Soviet Union. Last year, imports rose almost 11 percent to \$18.5 billion. In contrast to 1982 when foodstuffs were the only major category of imports to increase, last year China stepped up imports of industrial supplies and capital goods. In 1983, China placed new emphasis on purchasing technology. We believe payments for industrial know-how, production licenses, technical services, and various forms of consultancy may have reached \$2 billion during the year. We expect this trend to intensify as China moves more aggressively to remedy the technological backwardness that pervades most economic activity and to develop its indigenous capabilities for research and development. [redacted]

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Beijing is also beginning to make progress in attracting foreign investment. We estimate that at yearend 1983, total paid-in foreign investment amounted to approximately \$1.2 billion well above the \$400 million level of 1981. The main obstacles to better results in attracting investment remain China's inexperience, its stultifying bureaucracy which hampers the development of enduring relationships with foreign businessmen, and its lack of adequate infrastructure. Nevertheless, we expect foreign investment to increase further in part as a result of the September 1983 modification of China's Joint Venture Law, which provides for longer tax holidays and greater access to the domestic market. The exemption of joint ventures from import taxes earlier this year and the enactment of new laws clarifying the legal status of wholly-owned foreign companies, expected later this year, should further encourage foreign investment. [redacted]

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China's economic relationships with the Soviet Union also expanded in 1983, principally as the result of the easing in political tension between the two states. Sino-Soviet trade rose to about \$700 million last year and is planned to rise by 60 percent this year. There are also some indications that Beijing may be willing to consider a long-term trade agreement with Moscow. China also reportedly has agreed to use Soviet assistance in the technical upgrading of several industrial

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facilities built by the USSR in the 1950s. We continue to believe, however, that the Soviet and East European role in China's modernization will remain small, in part because of Soviet inability to provide technology as advanced as that available in the West and Japan, and in part because of Beijing's continued reluctance to allow any significant expansion of the now limited Soviet presence in China. [REDACTED]

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Foreign Policy

Despite the more nationalistic and independent stance in foreign policy adopted by China over the past two years Beijing's primary goals remain the same: security, economic modernization, and reunification. China still looks to the West and the United States in particular to counter Soviet expansionism. The need for access to Western technology and markets--to promote modernization domestically--has reinforced that decision. [REDACTED]

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After several years of "jolts and uncertainties", the Chinese have moved to establish smoother working relationships with the United States and used the recent visit of Premier Zhao Ziyang to do so. Although Beijing has publicly denied that it seeks a strategic partnership with the United States, it believes that good relations will strengthen its position in the Sino-USSR strategic triangle. While in Washington, Zhao stressed that US adherence to the bilateral communiques--especially the gradual reduction of arms sales to Taiwan--and avoidance of provocative public statements would suffice to "dispel the clouds" looming over US-China relations. Chinese leaders count on the United States making a significant contribution to their modernization program through technology transfer, US funding of international lending institutions, and greater investment by US business in Chinese industry. They also hope that improving political ties with the United States and being able to buy US arms will help counter Soviet pressure on China. [REDACTED]

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Although the Chinese and Soviets have taken some steps to improve bilateral ties--and will hold a fourth round of normalization "consultations" on 12 March--there has been no progress on the security issues that continue to divide them. Beijing still calls for an end to Soviet support for the Vietnamese invasion of Kampuchea, a Soviet withdrawal from Afghanistan, and troop reductions along their common border. The Soviets steadfastly refuse to discuss either Vietnam or Afghanistan, but have hinted that they might be willing to withdraw some of their forces from Mongolia if Beijing concludes a nonaggression agreement with Ulaanbaatar. Because the Soviets are committed to establishing themselves as a major Pacific power, they are unwilling to sacrifice their gains for the uncertain benefits of improved relations with China. [REDACTED]

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The Chinese are still attempting to determine the degree to which the United States is willing to assist China's economic--and by extension, military--modernization. Although the United

States moved China to Category V last year thus streamlining the export licensing process for many of the technologies Beijing wants, the technology transfer issue has joined the Taiwan issue as one of China's litmus tests of Sino-US relations. While Beijing remains acutely sensitive to how the United States treats these issues, it continues to express a strong desire for better relations. China views the forthcoming visit of President Reagan, as well as other meetings such as those of the Joint Economic Committee, as major steps to that end. [REDACTED]

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