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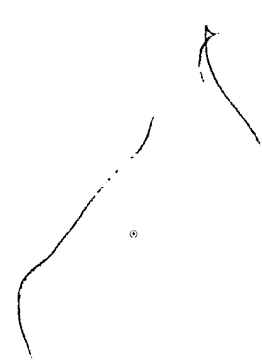
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China's Economic Reforms: Charting a Risky Course



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An Intelligence Assessment



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An Intelligence Assessment

This paper was prepared by 
 Office of East Asian Analysis. Comments
and queries are welcome and may be directed to
the Chief, China Division, OEA, 


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Key Judgments*Information available
as of 1 November 1984
was used in this report.*

The Third Plenary Session of the Chinese Communist Party's 12th Central Committee met 20 October to endorse a comprehensive "Decision on Reform of the Economic Structure." *If fully implemented*, the economic system most likely to emerge would rely on free market regulation to a degree unmatched elsewhere in the Communist world, with the possible exception of Hungary. Nevertheless, the economy will remain essentially socialist.

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The Central Committee's decision gave the party's political affirmation to structural changes that Chinese economic reformers have been advocating since late 1978. In principle, the plenum endorsed plans to:

- Reduce the scope of mandatory production plans and increase the role of guidance plans to enable enterprises to respond to market signals.
- Remove government and party institutions from the day-to-day business operations.
- Force enterprises formerly run by the state to become independent economic entities, competing against each other for profits, while maintaining tight state control over production and distribution of essential commodities and over most investment decisions.
- Allow enterprise management a greater measure of decisionmaking authority over hiring and firing, wages and bonuses, and even prices.
- Institute a rational price system to convey market information to enterprises.

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Deng Xiaoping, his heir apparent Hu Yaobang, and Premier Zhao Ziyang emerged as the clear political winners at the plenum. Ideas that Hu defended last year in the face of political opposition are the official line of the party. Party conservatives—such as Chen Yun—seem to have acquiesced in decisions that appear as a policy defeat for them. Other institutional winners and losers will emerge more clearly during the implementation period next year.

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We believe the reformist wing of the party pushed hard to formalize the commitment to reform while the 80-year-old Deng is still active and at the peak of his powers. In our view, they probably also were impelled by fears that if they did not expand reform:

- Strong agricultural performance of the last three years might not be sustained.
- The technological revolution ongoing in the West might leave China permanently behind.
- Piecemeal reform would lead to multiple failures.

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The implementation stage will be the first major test of China's reconstituted bureaucracy. We believe that critics of the reforms will attempt to slow policy implementation through a wide variety of bureaucratic subterfuges. Resistance will come both from leaders threatened by Beijing's call for younger, more educated managers and from ideologues who view the entire reform program as heretical and too pro-Western. [REDACTED]

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Economic problems will also threaten reform. We believe that the leadership's desire to institute rational prices is both the key to the success of the entire reform program and its greatest threat. The shortage-driven economy is susceptible to potentially destabilizing bouts of panic buying and bank runs. Shutdowns of noncompetitive enterprises, if not carefully managed, could also weaken the industrial base and create unemployment. [REDACTED]

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Beijing clearly recognizes both the potential gains and dangers of price reform and will move rapidly but deliberately in implementing changes. Because of the leadership's sensitivity to destabilizing price pressures, we believe the risk that it will move too slowly, and stall the entire reform package, is greater than the risk that too rapid an advance will spark economic instability. Some inflation should be expected as price adjustments work their way through the system, but we do not anticipate any long-term spiraling in prices. [REDACTED]

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Even if Beijing manages to weather its inevitable short-term problems, Deng's death or a combination of other setbacks—such as floods, drought, a succession of poor harvests, or a rapid rise in undesirable side effects of economic expansion (double-digit inflation, for example)—could over the longer term tip the political scales against reform and lead to a retreat. We believe the party would pay a political price as it sought to reassert its control down to the local level. Party leadership would again be seen as vacillating and unconcerned with the common welfare, precisely the image it seeks to dispel by implementing new policies. There might also be a prospect for active resistance by disaffected peasants or workers. The failure of reform would almost certainly presage a protracted period of political instability, as leaders struggled to fix the blame. [REDACTED]

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In our view, China is well positioned economically to survive the problems that will occur in the course of this most ambitious step in reform. Earlier policy changes have raised the agricultural sector to new heights in productivity. China's balance-of-payments position is among the world's strongest. Moreover, much of the fiscal and monetary framework necessary to control the more market-oriented system is in place. [redacted]

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Over the long run, we judge that the urban reform package will boost industrial productivity, albeit at a slower pace than experienced in the agricultural sector. The party is allowing itself five years to get the program in place and probably will hail even minor improvements in efficiency during that period as evidence of success. Nevertheless, the next year will provide a critical test of Beijing's willingness to accept the dislocations necessary to carry its plans through. [redacted]

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Successful implementation of the reform package will work to broaden China's ties with the West, creating new opportunities for investment and trade. We believe the reforms will have limited short-term effect on relations with Moscow. The Soviets have taken a cautious public approach to China's reforms—though they are privately critical—because of the sensitivity of such issues in Eastern Europe and within the USSR itself. [redacted]

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Failure of the reforms would probably have a negative impact on China's open-door policy and could present Moscow with an opportunity to press for improved relations. Even in the face of economic setbacks, however, China's foreign policy will be dictated primarily by strategic security considerations. [redacted]

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China's Economic Reforms: Charting a Risky Course

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Introduction

The Third Plenary Session of the Chinese Communist Party's 12th Central Committee convened for a single day on 20 October to endorse a sweeping "Decision on Reform of the Economic Structure." The Central Committee's decision was a comprehensive statement of China's economic policy that, if implemented as planned over the next five years, will change the face of Chinese socialism. The economic system most likely to emerge will mix free market regulation with Soviet-style planning in a fashion similar to that of Communist Hungary, Eastern Europe's pacesetter in innovative economic reforms.¹ Although advocates of reform, led by the 80-year-old Deng Xiaoping, have won a signal victory in gaining Central Committee approval of their program, they still face formidable hurdles—including probable administrative confusion, economic dislocation, and bureaucratic resistance—in implementing their controversial measures.

The plenum was preceded by six days of "preparatory meetings," at which the Decision was presumably explained in detail to various constituencies. We do not believe it was significantly altered during these meetings. Aside from the Decision on reform, the brief plenum produced two other documents: a terse communique that summarized the work of the meeting and a decision to convene a "National Conference of Party Delegates" in September 1985. The plenum set a two-item agenda for next year's conference: discussion and adoption of proposals concerning China's Seventh Five-Year Plan (1986-90), and selection of additional members of the Central Committee plus "other organizational matters." According to the communique, all three plenum documents were approved unanimously.

The Document

The Decision is a bold and risky attempt to come to grips with fundamental problems of the Chinese economy. It unquestionably is the strongest affirmation the party has ever made of its support for reform and is the economic benchmark of the Deng Xiaoping era. Nevertheless, the plenum document is not—as implied in the Western press—an unanticipated departure for economic policy nor is it a surprising announcement of some historic new trend, that is, the reintroduction of capitalism. Rather, it represents both an acceleration of the reform drive that began in December 1978 with the third plenum of the 11th Central Committee and a deepening of the shift, introduced at the May 1984 National People's Congress, away from the earlier emphasis on rural policy and toward urban reform. With the party's endorsement, the reform process will be accelerated and its scope will encompass a greater portion of the Chinese economy.

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The document begins by citing four characteristics of China's Soviet-style economic structure that drained enterprises of their initiative and vitality:

- The lack of clear distinction between functions of government and industry.
- "Excessive and rigid" state control.
- An inadequate role for prices and markets.
- The practice of "absolute egalitarianism."

It demands the creation of a "new socialist economic structure with Chinese characteristics." What Beijing envisions is an economic structure where major assets continue to be state owned, but where enterprise managers are free to respond in a competitive way to market signals. In the words of the document, the party seeks to create a system where "ownership can be duly separated from the power of operation."

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A New Relationship Between Government and Enterprise. The structural changes called for in the Decision are basically intended to remove the state and party from most day-to-day business decisions. To accomplish this, the entire national economic planning apparatus will be revamped. Strict mandatory plans, which previously dictated production and allocation quotas for most sectors of the economy, will now be applied only where essential commodities are involved.² According to the Decision, "other products and economic activities, which are far more numerous, should either come under guidance plans or be left entirely to the operation of the market." [redacted]

Guidance plans are to be "rough and flexible" guidelines on how much of each particular good the state deems desirable. Enterprises will be required to give first consideration to these plans, but, where local conditions make implementation of guidance plans unreasonable—for example, because of energy shortages or peculiarities in supply and demand—the firms will be free to deviate from plan without penalty. Enforcement of guidance plans will be accomplished mainly through the use of economic levers such as interest rates, bank lending policies, and taxes. [redacted]

Enterprise management responsibilities under the plenum plan are to be greatly expanded. Specifically, most enterprises are expected to become "relatively independent economic entities," responsible for their own profits and losses. Not only will they have more control over what and how much they produce and over their finances, they will also have authority—within as yet undefined limits—to hire and fire workers, to set wages and bonuses, and even to set product prices. [redacted]

Although the new program calls for a weakening of the role played by state bureaucracies, their power nevertheless remains significant. By any objective standard, China will remain socialist in its essentials. In addition to the continued importance of the central planning apparatus and strict control over products of national importance, the state will continue to appoint

² China recently published a list of essential commodities, which included coal, oil and petroleum products, steel, nonferrous metals, timber, cement, chemicals, electricity, munitions, and other items. Agricultural products on the list included cereals, cotton, edible oils, tobacco, pigs, and some aquatic products. [redacted]

and remove key enterprise managers and hence to exert a powerful, if indirect, influence on production decisions. Moreover, when enterprises experience financial problems, it is the state that will determine which firms will be subsidized, and which will be forced to merge or shut down. [redacted]

Price Reform—The Key to Success. The plenum brought to an end the party's unwillingness to come to grips with China's most serious economic problem, irrational prices. Until now Chinese leaders have been reluctant to advocate major price reform for fear of sparking potentially destabilizing inflation, hoarding, and speculation. The plenum document explicitly recommends establishment of a "rational price system," calling it the key to reform of the entire economic structure. The fact that Beijing hopes to have its now totally irrational price system corrected in only five years is an indication of the party's commitment to rapid reform. [redacted]

To carry out its program, Beijing will gradually reduce the number of items subject to state-set fixed prices. Most product prices will be allowed to fluctuate—according to changes in supply and demand—within narrow bands set by the state. Floating prices will be used for a small number of consumer products and for most services provided by individual entrepreneurs. For essential goods, the state will retain tight control, but major adjustments are probable even here as Beijing attempts to bring its raw material and energy prices into line with the current world economic situation.³ [redacted]

Recognizing the sensitivity of the local population to price changes—many Chinese remember the hyperinflation of the late 1940s—Beijing's plans for rationalizing prices are cautious. The plenum document emphasizes that price reform will be implemented "gradually, in a step-by-step" fashion. It promises that "the real income of urban and rural inhabitants will not go down as a result of price readjustments." The document also warns potential entrepreneurs that

³ Coal, which is greatly underpriced in China, will probably be one of the first targets of state-controlled price adjustment. [redacted]

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it is "absolutely impermissible for any unit or person to boost prices at will by taking advantage of the reform." [redacted]

Absence of Dogma. The Decision is starkly lacking in standard Marxist or Maoist points of reference and will strike some doctrinaire party veterans as very questionable ideology. In an attempt to undercut such criticism, the drafters use a combination of argument and assertion to persuade readers that the new policies will achieve "socialism with Chinese characteristics." The document, which is markedly defensive in some passages, justifies its conclusions ideologically by re-defining what is socialist. For example, to account for labor and commodity policies that smack of capitalism, the document asserts that, at its current stage of development, China needs a "socialist commodity economy." The essence of socialism, the Decision argues, lies in the public ownership of the means of production, and not in such things as rigid central planning or egalitarianism. We believe the weakness of the Decision's ideological foundation will require the party to defend it frequently against both internal and foreign critics. The Chinese are acutely sensitive to the charge that the reforms constitute a return to "the capitalist road." [redacted]

The Decision also supports other controversial reforms on Deng's agenda: China's opening to the West, the promotion of intellectuals and professionals, and new standards for performance of party members. By tying these policies directly to economic reform, Deng seems to be telling his supporters, some of whom may disagree on specific points, that the program is all or nothing. [redacted]

A Matter of Timing

Now or Never. Facing an already ambitious political and economic agenda, why did Deng and his allies choose this time to move across so broad a front? We believe that the urgency behind these latest steps springs from a perceived need to do as much as possible while Deng is physically able to remain personally involved. For all his intentions to emplace a durable leadership to succeed him, Deng, now 80, remains the key player in China's leadership. Although Hu Yaobang and Zhao Ziyang, standing at the pinnacle of the party and state bureaucracies, are powerful figures in their own right and have been

heavily involved in overall reform policy formulation, neither commands the loyalty of Deng's following or enjoys Deng's preponderant authority and prestige. Reform can proceed without Deng, but the way will be more hazardous. [redacted]

The Chinese leadership has been strikingly frank in assessing the controversial nature of the Decision. For example, Hu Yaobang, while maintaining that "the overwhelming majority of our comrades will be elated and inspired," noted at one of the preparatory meetings that not everyone would agree with the Decision because of the "varying depth of understanding and different interests at stake." In our view, Hu's statement is unusually realistic in admitting the role of interests—personal, institutional, or otherwise—in determining individual opinion. [redacted]

Hu's statement also epitomizes the confidence of Deng and his allies. They have said publicly that some cadre may "trail behind" in their understanding of reform, and that, as long as they did not actually oppose reform, they would be given time to study and catch up. It seems evident that Deng and Hu believe the rectification of party and government leadership groups—generally complete at the provincial level and continuing locally—has been successful. Late last summer Hu told foreign visitors that a million officials had already retired and by yearend a million more would go. In our view, this leadership turnover is a key prerequisite for successfully implementing the controversial economic reforms. [redacted]

A Sound Economic Foundation. China is well positioned economically to survive the problems that inevitably will arise from the planned overhaul of the economic structure. Earlier reforms have elevated the agricultural sector to unprecedented productivity. Grain output in 1984 should hit record levels for the third consecutive year. Moreover, China's balance-of-payments position is one of the strongest worldwide. International reserves exceed US \$20 billion, the debt

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service ratio is under 6 percent, and Beijing has gradually depreciated its currency to a point that should discourage enterprises from abusing their new-found import autonomy. [redacted]

Moreover, much of the fiscal and monetary framework necessary to control the more market-oriented system is nearly in place.⁴ The tax system began a final stage of overhaul on 1 October. Most enterprises no longer remit profits to the state, but instead pay a regular income tax that Beijing can alter to influence economic behavior. The banking system has also seen major changes that enable it to better control the more flexible economic structure. Earlier this month Beijing announced that the central bank—the People's Bank of China—is now allowing local banks to retain a larger portion of their own reserves and to borrow from, or lend to, other banks. Bank loans are rapidly replacing government allocations as the main outside source of investment funds for enterprises. In addition, interest charges are for the first time making enterprises sensitive to the cost of money. We believe these reforms put the central bank in a stronger position to control the nation's money supply. [redacted]

The Economic Imperative. Although the conditions necessary for change have been improving, the pressure to do so has also been mounting. According to leading Chinese economists, the immediate rationale for moving ahead was concern about the drag that the urban economy is placing on progress in the rural sector. Recent Chinese press accounts indicate that grain stocks are building and sometimes rotting in the countryside because China's commercial and transportation network is incapable of handling the increased output. Peasants reportedly are experiencing difficulty turning their increased earning power into consumption because of the inadequate flow of consumer goods from urban to rural areas. Both problems may already be cutting into peasant willingness to push for further agricultural gains. [redacted]

The failure of earlier reforms to generate productivity gains in industry is also exacerbating China's energy problems. Chinese economists realize that without sharp improvements in industrial efficiency the goal of quadrupling output by the year 2000 is unattainable. Power shortages reportedly idle 20 percent of production capacity, yet Chinese industry continues to

use three and a half times more energy to produce a unit of industrial output than does the average LDC. The reformers appear to believe that only by forcing managers to face a competitive environment with rising energy prices can efficiency gains be achieved. [redacted]

The Leadership Picture

The party characteristically sought to convey an impression of unity at the October meeting. Of the six members of the Politburo Standing Committee, only Ye Jianying, who reportedly is very ill, failed to attend. The remaining five, including Chen Yun in a rare public appearance, collectively presided over the meeting. Marshal Nie Rongzhen—85 and ailing—was the only other member of the Politburo and Secretariat who failed to turn out. [redacted]

Although Chen Yun has yet to comment publicly, we tentatively conclude that the plenum was a policy defeat for him and other party conservatives. Many of the Decision's pronouncements on such topics as economic balance, investment priorities, and control of inflation bear Chen's imprint, but these are issues on which there is much agreement in the party. The Decision goes considerably beyond Chen on the crucial issue of central control and seems to disavow his insistence on finely detailed planning as the foundation for the macroeconomy. We believe Chen's conspicuously low public profile since the waning of the spiritual pollution campaign gives credence to rumors that he in some way was linked to mistakes at that time or that he is no longer well enough to press his views. [redacted]

Aside from Deng, Hu is the clear victor in this political round. In early 1983 Hu strongly endorsed an acceleration of reform, but his ideas generally were ignored, even obliquely attacked by other senior leaders, and, in the press of other priorities, reform efforts stagnated. Later that year, Hu was clearly on the defensive in the spiritual pollution campaign. Yet, ideas Hu promoted last year in the face of criticism have now become the official line and policy of the Central Committee. [redacted]

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The Road to the Plenum

In January 1984 the political atmosphere did not appear conducive to the promotion of major structural reforms, despite a People's Daily New Year's editorial that subordinated all other tasks to economic construction. At that time, China was still awash in the rhetoric of the campaign against spiritual pollution, which Deng had kicked off at the Second Plenum in October 1983. That drive faded in late December after Hu, Zhao, and other senior leaders went to Deng with evidence that the campaign was being misused by conservative elements in the party to attack a broad range of policies, including agricultural reforms. It is possible, therefore, that the party's reformist wing, after containing the spiritual pollution campaign, decided to forcefully reassert reformist priorities and press forward with long delayed proposals for major structural changes. [redacted]

During January-March several important events occurred that imparted greater momentum to reform efforts:

- Deng Xiaoping toured and publicly praised China's Special Economic Zones.
- Hu Yaobang traveled through the southwest and set off a campaign against local factionalism.
- Economic moderate Chen Yun, an advocate of rural reform but also of tight central planning, sharply reduced his public activities, possibly because of illness.
- The official media intensified their coverage of rectification and reform topics such as the treatment of intellectuals and the need for price reform. [redacted]

Several major party and government meetings were held in the spring. One of the most important was an expanded Politburo session on 30 April that approved the opening of 14 port cities to foreign commerce. We assume these meetings also worked out the themes and business of the Second Session of the Sixth National People's Congress (NPC) that convened in May. Premier Zhao Ziyang's speech to the NPC was the high water mark of the spring reformist current. Zhao revived several ideas that had lost some currency following the onset of the economic readjustment policy in early 1981, such as the devolution of decisionmaking responsibility to enterprise managers and the importance of workers' congresses. He announced the State Council decision to accelerate urban reform and foreshadowed the party's departure

from socialist orthodoxy by bluntly insisting that "we must encourage competition (among enterprises) and prevent monopoly." [redacted]

The available evidence suggests that party reformists wanted to formalize their controversial new program with a central committee resolution. Another party session, probably in late July or early August, apparently worked on a late, if not final, draft of the Decision on Economic Reform.^a Shortly thereafter, a diverse collection of national leaders—including Hu, Zhao, Wan Li, and others—began to tour the provinces, apparently to generate support for the impending policy changes. Around the same time, Politburo members openly began to discuss the agenda of the Third Plenum and the party's decision to convene a Congress of Delegates (at first misunderstood to be a party congress) in 1985. [redacted]

In response to top-level encouragement, provincial and ministerial leaders began taking bolder steps at reform. Factories in the city of Chongqing, for example, were reported to be experimenting successfully with a program allowing them to direct their own production, marketing, hiring, and firing, and to establish their own managerial systems. In August and September the State Council ordered several major state organizations—including the Ministry of Foreign Economic Relations and Trade, the Ministry of Machine Building, and the Ministry of Coal Industry—to relinquish day-to-day conduct of business and instead to become formulators of broad policy guidelines for their respective industries. [redacted]

Just before the plenum convened, the State Council published "Provisional Regulations on Improving the Planning System." Although we have yet to see a copy of the regulations, Chinese press accounts suggest that they cover most of the major elements of the program subsequently approved by the party plenum, and indeed that they provide even more detail on how particular industries and products would be affected by the new program. This unusual public discussion of the plenum's agenda contributed to the reformist momentum and made it appear that the plenum was held simply to legitimize a fait accompli. [redacted]

^a As with the controversial 1981 assessment of the party's history, the draft of the Decision on Economic Reform was circulated to about 1,000 "experts" prior to the plenum. [redacted]

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Zhao has also gained through his long and clear association with many of the ideas expressed in the Decision. Moreover, Zhao crisscrossed the country during the months preceding the plenum, apparently to do advance work for the coming policy changes. While on the road, he delivered important speeches that amplified his May address to the NPC and included fresh ideas on technical renovation in factories, the velocity of money in circulation, and the importance of China's opening to the world. [redacted]

The main institutional winners and losers will emerge more clearly over the next year as Deng and company move from policy formulation to implementation, but we believe certain categories of officials can be roughly assessed now. Aside from the party's reform wing, other generic winners include the growing group of relatively young, educated professionals and intellectuals whom the party has courted so assiduously over the past year. In particular, those alternate members of the Central Committee who were selected for their exemplary professional characteristics can look forward to enhanced career prospects in a hospitable policy context. [redacted]

The party's planning apparatus will continue to play an important role within its narrowed confines, but nonetheless has been divested of many responsibilities. National foreign trade officials—among them Politburo alternate Chen Muhua, who seems perennially awaiting demotion—will lose authority to local trade officials and enterprise managers, who have received expanded power to strike their own deals with foreign traders. Whole categories of ministerial-level officials, accustomed to directly commanding entire sectors of the economy, must rest content with establishing broad policy guidelines and overseeing implementation, while plant managers get on with their profit seeking. [redacted]

No Breathing Space

Political Shoals. The leadership recognizes that Central Committee endorsement plus reliable personnel well-placed to oversee execution does not equate to policy implementation. Until regulations, laws, and administrative decisions on implementation are published and acted on, the Decision is only an enumeration of intentions, a wish list. We expect, therefore, that the plenum's Decision will be a major test for

China's reconstituted bureaucracy and its ability to weave disparate policy strands into a coherent fabric of reforms. [redacted]

The enthusiasm surrounding the Decision—whether spontaneous or manufactured—may momentarily mute voices critical of extensive economic reform. The longstanding debate over economic policy, however, cannot be considered resolved. Few such controversies ever reach satisfactory closure, as the experience of China's rural reforms—which remained periodically under fire even after promoting bumper harvests—amply demonstrates. We believe critics of reform will seize upon problems during the transition period to press for policy reversal or modification. [redacted]

These potential critics are located throughout China, although generally not in the most important posts. They have the ability to slow down the process of policy implementation through a wide variety of bureaucratic subterfuges. They probably fear that Deng's current initiative requires removing officials like themselves, who lack the training, knowledge, or vigor to promote change. To these party hacks, party personnel chief Qiao Shi's recent promise to replace within a year 40 percent of all top managers and 70 percent of all party secretaries in 3,000 key enterprises must sound like a war cry. In self-defense, these cadre can be expected to take every opportunity to criticize and block the implementation of reforms. [redacted]

Finally, to some within the party, the Decision may represent the single greatest instance of "spiritual pollution" in the 35-year history of the People's Republic. The ideological concerns that gave rise to last year's drive to eliminate bourgeois influence remain alive. Indeed, Deng, Hu, and their reformist allies share a preoccupation with the effect of reforms on the party's ability to manage Chinese society, and the issue could possibly be revived under another slogan. Although we believe that the drafters of the Decision sought in the text to allay these concerns, we suspect that older party traditionalists will be monitoring developments for signs of "bourgeois decadence," "corrosive ideology," and a chance to exploit these phenomena once again. [redacted]

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Economic Problems Ahead. Introducing price reform into China's shortage-driven economy probably poses the most immediate threat to the reform program. The plenum's call for price reform reportedly has sparked a few bank runs and some panic buying, despite assurances that prices would be adjusted slowly and that consumer income would not be allowed to suffer. Further problems can be expected as Beijing attempts to bring prices for essential goods such as cereals, industrial raw materials, and coal in line with costs. [redacted]

Another economic hurdle that the leadership must cross in the immediate future is the question of corporate bankruptcy. Last year, nearly one-fourth of China's industrial enterprises were unprofitable, and this year, even after the government exerted strong pressure for improvement, 16 percent are still operating in the red. Clearly, Beijing cannot allow a massive shutdown of such a large portion of its industrial base, but to continue to subsidize losses reduces pressure on the enterprises to improve. [redacted]

Perhaps more important, even if the government proved willing to accept large-scale shutdowns, it has no suitable criteria for determining which enterprises are operating efficiently. Several major industries, including coal and some textiles, are unprofitable simply because their output prices have been fixed at artificially low levels. Until price reform can be implemented, Beijing must devise some measures for determining which enterprises should be closed because they are poorly managed and which should continue to receive subsidies. In all likelihood, the government will be cautious and allow a large number of inefficient firms to operate. [redacted]

Where firms are forced to close, the accompanying unemployment problems may be locally destabilizing. Beijing has historically prohibited the free movement of the population in order to prevent massive migration from the countryside to the cities. If major industries are allowed to fold, certain geographic areas could face high unemployment rates for long periods of time. Here, too, we believe Beijing's inclination will be to accept inefficiency rather than promote serious unemployment. [redacted]

Unfinished Business: A Critical September Meeting A New Central Committee? The plenum deferred a wide variety of personnel moves that apparently will be taken up at the special party Conference of Delegates scheduled for next September. According to both Hu Yaobang and Hu Qili, personnel moves involving high party offices are among the "other organizational matters" on the conference agenda. The "election of additional members to the Central Committee," the main organizational measure announced, is generally the province of formal party congresses. However, Deng and his political heirs may be impatient to rejuvenate the committee itself. Moreover, membership on the Central Committee confers an automatic status in the party that Deng, Hu, and company may wish to grant intellectuals and technocrats as a token of political good faith.³ In our view, a number of aged party veterans will probably be replaced through the promotion of alternate members to full membership. [redacted]

Politburo Shifts? The party leadership almost certainly could have taken care of personnel questions at the recent plenum, but perhaps at the risk of tarnishing the highly prized image of stability and unity. Rumors current in Beijing and Hong Kong last summer suggested that the six-man Politburo Standing Committee would take on one or two new members. Although Zhao Ziyang recently suggested [redacted] that the Standing Committee never meets and the Politburo seldom does, the most powerful men in China, nevertheless, sit on these two bodies. Although we believe it has been politically useful to crop the aged Politburo out of much policymaking—allowing the Secretariat and the State Council to handle most work—Deng or his successors may eventually want it to resume a more prominent role in framing policy guidelines. If so, many of the Politburo's octogenerian leaders are overdue for replacement. [redacted]

³ The conference is to be attended by "about 1,000" delegates, chosen from the ranks of scientists, technocrats, provincial party secretaries, soldiers, and current Central Committee members. This compares with 1,545 delegates who attended the 12th Congress. It is possible Deng will attempt to "pack" the Central Committee by careful selection of delegates, all of whom will have the right to vote for new members. [redacted]

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Secretariat Additions? Comments Hu Yaobang made recently to visiting foreign dignitaries indicated that several members of the party Secretariat would probably be replaced at the September meeting. We cannot safely predict who will go, but candidates are those aged leaders who sit on both the Secretariat and the Politburo, such as Xi Zhongxun and Yu Qiuli, as well as those who have hovered near or are currently in political disgrace, such as Deng Liqun. It is possible that three or four places will open up (more if the body expands to accommodate a greater workload). The obvious candidates for promotion would appear to be alternate Secretariat members Qiao Shi and Hao Jianxiu. General Office director Wang Zhaoguo and International Liaison Department chief Qian Liren might also be added. Xu Xin, a rapid riser in the General Staff Department, could conceivably gain the military seat vacant since the death of Yang Yong.

Rectification Redefined? The most ambitious personnel measure of all, the party rectification now in its second year, received short shrift at the plenary session. Although the drive to reform, rejuvenate, and discipline the party has progressed approximately on schedule and in 1985 will extend into cities, counties, and enterprises, the plenum issued no progress report and addressed the campaign only in the final section of the Decision on Economic Reform.

Although Beijing will continue to purge Cultural Revolution beneficiaries who were guilty of serious criminal acts, the line has softened somewhat over the past year, with far greater emphasis on forgiving and forgetting. Beijing seems to believe that rectification should try to break, not perpetuate, the self-destructive cycle of recrimination and mistrust that has driven Chinese politics since 1949. It has therefore stressed the need for lenient treatment of old cases, while still insisting that younger officials to be promoted must not have been involved in the Cultural Revolution to any great extent.

In general, however, we do not believe that the party leadership's commitment to rectification has flagged. Indeed, bureaucratic restructuring at all levels remains the key to the success of the implementation phase of reform, and the Decision pointedly links the two. The document lays down what has become the

new bottom line: one's ability and willingness to promote reforms is a strong indication of one's continuing suitability as a party member.

The Next Five-Year Plan. The other major piece of business on the agenda of next year's Conference of Delegates is the Seventh Five-Year Plan (1986-90). The formulation of the plan is absolutely critical for the implementation of the new policies approved by the plenum. Advance reports in the official media suggest that Beijing will concentrate on renovating existing industrial plants, holding the line on capital construction investment and allowing enough flexibility for the new reforms to take effect.

Prospects

Whither the Party? The success of Beijing's economic policies carries both opportunities and risks. Success would reinforce party legitimacy and help curb the so-called crisis of confidence in the party's leadership. Moreover, it would arm the party's reform wing against its detractors (and their failed policies) and would strengthen the positions of Hu Yaobang and Zhao Ziyang in a post-Deng regime. More than any other leaders, they have staked their political futures on the outcome of the reforms. Successful reform would indicate that substantial progress has been made in reforming China's aging and poorly trained bureaucracy, presaging greater stability and cohesiveness within the party as a whole. It would also facilitate the continuing admission of managers and engineers to the membership in order to better enable the party to meet future political and economic challenges.

At the same time, by devolving some economic decision making power and promoting individual entrepreneurship, the party runs the risks of establishing spheres of activity that may grow immune to party tutelage. Successful reform will inch the Chinese economy closer to the "consumer sovereignty" and producer responsiveness that characterize capitalist economies and that are so antithetical to central planning. Acclimating the populace to make economic choices freely may lead to corresponding demands for

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political liberalization, as happened in the 1978-80 period. The leadership appears to believe it can control these political strains, in part because the party retains its monopoly over the instruments of coercion. Furthermore, as the performance of Chinese-run economies of Taiwan, Hong Kong, and Singapore demonstrate, economic vitality is compatible with political docility. [redacted]

Whither the Economy? Beijing is committed to immediate price adjustment, but it also clearly recognizes the potential for panic that price reform raises and will move very deliberately to implement changes. In fact, we believe the risk that the leadership will move too slowly with essential price adjustments—and stall the entire reform package—is greater than the risk that too rapid an advance will spark economic instability. Nevertheless, it is safe to assume that price reform will be somewhat inflationary in the short run. Most adjustments will probably be upward, and important products such as coal, oil, and certain foodstuffs will eventually undergo steep revisions. The reforms may occasionally spark bouts of panic buying as consumers draw down savings deposits that are now at record levels. Beijing is most likely to respond to these periodic bouts by ordering producers to hold the line on prices, and by raising interest rates and taxes to discourage consumption. [redacted]

We do not believe there is significant risk of serious long-term inflation. For this to occur the government would have to be willing to sustain the increases in consumer demand by printing money. Although some subsidies or wage increases will be offered in the early stages of the adjustment process—to help ease concerns about eroding purchasing power—the conservative government is unlikely to resort to any long-term use of the printing press to finance consumer spending. [redacted]

In light of the many problems, we do not expect the benefits of urban reform to match those experienced under the agricultural reform program. But neither does Beijing. The party is allowing itself five years to get the program in place and probably will hail even minor improvements in efficiency during that period as evidence of success. The fact that Beijing is going into this program with its eyes open increases the probability that it will be able to resist pressures to

revert to tight central planning when problems arise. Nevertheless, the next year will provide a critical test of the government's willingness to accept the dislocations necessary to carry the program through. [redacted]

If Beijing can resist pressure to back away from reforms in the face of mounting problems, we believe long-term productivity will increase and economic growth will accelerate. Government efforts to encourage surplus labor to take up private commerce and service activities have considerable potential for increasing both agricultural and industrial productivity. The renewed emphasis on enterprise autonomy also bodes well for productivity increases, some of which will go unobserved in Beijing as enterprises attempt to understate profits to avoid taxes. [redacted]

A Worst Case Assessment. Deng and his allies have indicated they expect that the early going will be rough and are prepared to ride out short-term problems, such as panic buying and isolated runs on banks. If those problems persist, or get worse, critics of reform will almost certainly seize on the dislocations to call for a return to direct central control, even though this alternative has demonstrably failed to promote efficiency in the past. Although reform advocates seem to hold the balance in party councils now, party and military conservatives could coalesce into a potentially powerful political bloc if economic problems became socially destabilizing. [redacted]

Even if Beijing manages to weather its inevitable short-term problems, Deng's death or a combination of setbacks—such as floods, drought, a succession of poor harvests, a rapid rise in undesirable side effects of economic expansion such as price gouging, speculation, or graft—could over the longer term tip the political scales against reform and lead to a retreat. [redacted]

Retrenchment on reforms would confront the party with serious political difficulties as it sought to reassert its control down to the local level. At a minimum,

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the party leadership would again be seen as vacillating and unconcerned with the common welfare, precisely the image it seeks to dispel by implementing new policies. At worst, disaffected peasants or workers might engage in active or passive resistance. The failure of reform would almost certainly bring on a protracted period of political instability, as leaders struggle for the right to affix the blame. [redacted]

Foreign Policy. In our judgment, implementation of the reforms will both broaden and deepen China's ties with the United States and the West, but will not, at least in the short term, have much impact on Sino-Soviet relations. [redacted]

The emphasis on technological innovation at the plant level, foreign capital acquisition, and increased joint ventures will expand investment and trade opportunities for US and Western businesses. In addition, we expect that Chinese enterprise managers will take advantage of their new flexibility to tap the West for increased amounts of information, training, and managerial expertise. [redacted]

At the same time, however, the reforms will aggravate some current problems in US-Chinese relations. It can be expected that Chinese enterprises will want access to Western markets to sell their products, so Beijing's pressure on Washington to lower trade barriers will increase. Similarly, Beijing will probably press Washington harder on technology transfer in response to the demands of its own enterprises. It is also likely that China will reduce its grain imports from the West as its agricultural production continues to improve. [redacted]

The Soviet reaction thus far has been cautious, and Soviet media have been only indirectly critical of Chinese reforms. *Pravda*, for example, has replayed Chinese commentary critical of midlevel cadre who oppose the reforms and US commentary stressing the radical nature of the change and the disruptions that the reforms will cause in the economy. Moscow will continue to treat the issue delicately because of concern about fueling the debate within Eastern Europe—as well as domestically—over economic reform. The Soviets may try to exploit the reforms by offering China increased assistance for those factories originally built with Soviet technology. [redacted]

Privately, Soviet China watchers have been more critical. In characteristic fashion, they have said that the Chinese reform package is cosmetic, unlikely to last long, a reflection of a power struggle within the Chinese leadership, and a deviation from Marxism-Leninism. We do not believe, however, that these comments will be aired in direct Soviet media commentary any time soon, unless Moscow reverts to the tough policy of last summer, when it temporarily lifted its ban on criticism of Chinese domestic developments. [redacted]

Failures in the reform program, on the other hand, will almost certainly have negative consequences for China's open-door policy, as foreign economic issues become embroiled in the inevitable infighting within the leadership. Although the Soviets might hope to exploit such a situation, and would almost certainly be reassured at the reemergence of what they would see as more "orthodox" economic planning, the fundamental security issues that divide China and the USSR would remain. Unless Moscow is prepared to address Chinese security concerns, even a more conservative leadership in Beijing would probably still look to the United States as a strategic counterweight to the Soviet Union. [redacted]

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Appendix

Extracts From the CCPCC Decision on Reform of the Economic Structure (Adopted 20 October 1984)

The Third Plenary Session of the 12th Central Committee . . . holds the consensus view that . . . we must go a step further with the policy of invigorating the domestic economy and opening to the outside world and accelerate the restructuring of the national economy as a whole, with the focus on the urban economy, so as to create a new, better situation for our socialist modernization.

I. Reform Is a Pressing Necessity in the Current Developments in China

. . . There is an urgent need to unclog the channels of circulation between town and country, expand the market for the increasing amount of agricultural products, and satisfy the rising needs of the peasants for manufactured goods, science and technology, as well as culture and education. Our successes in rural reform and the demands on the cities by the growing rural economy provide highly favorable conditions for restructuring China's entire national economy, focusing on the urban economy.

. . . Defects in the urban economic structure that seriously hinder the expansion of the forces of production are yet to be eradicated. . . Firm, systematic reform is the only way that the cities will play their due leading role.

. . . Emerging on a global scale is a new technological revolution that presents new opportunities and challenges to our economic growth. . . Reform, therefore, is all the more imperative.

II. Reform Is Aimed at Establishing a Dynamic Socialist Economic Structure

. . . The profound changes that have taken place in the 35 years since the founding of the People's Republic are an initial demonstration of the superiority of the socialist system. But this superiority . . . has yet to be brought into full play A major economic cause for this is a rigid economic structure that cannot meet the needs of the growing forces of production. The following are the major defects of this structure: no clear distinction has been drawn between the functions of the government and those of the enterprises; barriers exist between different departments or regions; the state has exercised excessive and rigid control over enterprises; no adequate importance has been given to commodity production, the law of value, and the regulatory role of the market; and there is absolute

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equalitarianism in distribution The enthusiasm, initiative, and creativeness of enterprises and workers have, as a result, been seriously dampened, and the socialist economy is bereft of much of the vitality it should possess.

To bring about a radical change in the economic structure . . . we must conscientiously sum up China's historical experience and study the concrete conditions and requirement for economic growth. In addition, we must draw on the world's advanced methods of management, including those of developed capitalist countries, that conform to the laws of modern, socialized production.

. . . The essential task of socialism is to develop the forces of production, create even more wealth, and meet the people's growing material and cultural needs. Socialism does not mean pauperism, for it aims at the elimination of poverty.

III. Invigorating Enterprises Is the Key To Restructuring the National Economy

One of the main reasons that the state exercised excessive and rigid control over enterprises in the past was to equate the concept of their ownership by the whole people with the concept of their direct operation by the state institutions. . . . Ownership can be duly separated from the power of operation. . . . Socialist state institutions must manage, inspect, guide, and regulate the activities of the enterprises, as is necessary, through planning and by economic, administrative, and legal means; (the state) must use taxation and other means to concentrate in its treasury that part of enterprises' net income that should be used by the state in a unified way; it must designate, appoint, and remove the principal leading members of the enterprises or approve their appointment and election; and it must decide on the establishment of enterprises, their removal to other places, their switching over to other lines of products, their merger with others, suspension of operations, or closing down.

. . . However . . . no state institution can know the whole situation fully and cope with everything in good time. Therefore . . . the enterprise has the power to adopt flexible and diversified forms of operation; plan its production, supply, and marketing; keep and budget funds it is entitled to retain; appoint, remove, employ, or elect its own personnel according to relevant regulations; decide on how to recruit and use its work force, and on wages and rewards; set the prices of its products within the limits prescribed by the state; and so on. In short, the enterprise should be truly made a relatively independent economic entity and should become a producer and operator of socialist commodity production that is independent and responsible for its own profit and loss and capable of transforming and developing itself, and that acts as a legal person with certain rights and duties.

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(Establishing correct relations between the state and the enterprise) inevitably calls for reform of every aspect of the entire economic structure . . . (involving) . . . a whole range of reforms including planning, pricing, economic management by state institutions, and the labor and wage system. The Central Committee is of the opinion that these reforms should be carried out step by step in harmony with the inherent connections between the various links of the national economy, according to the degree of ripening of the subjective and objective conditions and in the right order of importance, urgency, and feasibility, and that they should basically be accomplished in about five years. Specific plans will be drawn up separately to this end.

IV. Establish a Planning System Under Which the Law of Value Is Consciously Applied for Developing a Socialist Commodity Economy

Socialist society practices a planned economy on the basis of public ownership of the means of production. . . . Since the founding of the People's Republic, we have practiced a planned economy and concentrated vast financial, material, and human resources on large-scale socialist economic construction, with tremendous achievements to our credit. At the same time, historical experience shows that the socialist planning system should be one that combines uniformity and flexibility. . . . We must realize that because of China's rather undeveloped commodity production at the present stage, it is necessary to stimulate commodity production and exchange.

. . . If we try to incorporate all economic activities into the plans and implement them by administrative orders alone in disregard of the importance of the economic levers and the market, then there will unavoidably be a discrepancy between the subjective guidelines for planning and objective conditions, with the plans seriously out of step with reality. . . . We must be realistic and admit that, for a considerably long time to come, our national economic plans on the whole can only be rough and elastic and that we can do no more than, by striking an overall balance in planning and through regulation by economic means, exercise effective control over major issues while allowing flexibility on minor ones.

. . . It is necessary, first of all, to discard the traditional idea of pitting the planned economy against the commodity economy. We should clearly understand that the socialist planned economy is a planned commodity economy based on public ownership, in which the law of value must be conscientiously followed and applied. The full development of a commodity economy is an indispensable stage in the economic growth of society. . . . Meanwhile, we must realize that the extensive growth of a socialist

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commodity economy may also lead to certain disorder in production, and there have to be guidance, regulation, and administrative control through planning. . . . The difference between socialist and capitalist economy . . . (lies) . . . in the difference in ownership, in whether there is an exploiting class and whether the working people are masters of the state, in the different purposes of production, in whether the law of value can be consciously applied throughout society, and in the different scopes of commodity relations.

. . . The basic characteristics of our planning system: first, ours is on the whole a planned economy . . . not a market economy. . . . Second, production and exchange completely subject to market regulation are confined mainly to certain farm and sideline products, small articles of daily use and labor services. . . . Third, our planned economy does not necessarily mean the predominance of mandatory planning, both mandatory and guidance planning being its specific form. Fourth, guidance plans are fulfilled mainly by use of economic levers, mandatory plans have to be implemented, but even then the law of value must be observed. . . . It is necessary . . . to reduce the scope of mandatory planning and extend guidance planning. Mandatory planning will be applied to major products. . . . Other products and economic activities which are far more numerous should either come under guidance planning or be left entirely to the operation of the market. . . . The focus of planning will be shifted to medium- and long-term planning, and annual plans will be appropriately simplified.

V. Establish a Rational Price System and Pay Full Attention to Economic Levers

. . . The various aspects of the reform in economic structure, including planning a wage system, depend to a large extent on reform of the price system. Pricing is a most effective means to regulation, and rational prices constitute an important condition for ensuring a dynamic, yet not chaotic, economy. Therefore, reform of the price system is the key to reform of the entire economic structure.

The irrational system of pricing is closely related to the irrational system of price control. In readjusting prices, we must reform the overcentralized system of price control, gradually reducing the scope of uniform prices set by the state and appropriately enlarging the scope of floating prices within certain limits and of free prices. . . . When the price of some mineral products and raw and semifinished materials is raised, the processing enterprises must substantially cut down consumption so that the increased production cost resulting from the higher price of such products and materials can be basically offset within the enterprises, with only a small part of the increase being borne by the state through tax reductions and exemptions. This will avoid a consequent rise in market sales prices.

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. . . We must adopt effective measures to ensure that the real income of urban and rural inhabitants does not go down as a result of price readjustments. . . . The pay of workers and staff members will have to be raised gradually. It must be widely publicized among the people that. . . (price reform) . . . will never bring about a general and spiraling price rise. . . . It is absolutely impermissible for any unit or person to boost prices at will by taking advantage of the reform, deliberately generating a tendency toward a general rise in prices, disrupt the socialist market, and harm the interests of the state and the consumers.

VI. Separate Government From Enterprise Functions So That Government Organs Can Properly Perform Their Function of Managing the Economy

. . . The functions of government for a long time were not separated from those of enterprises, which in fact became appendages of administrative organs, and the central and local governments took responsibility for many matters which were not really theirs and at the same time did not do well what they ought to do. This, plus the barriers between different regions and the practice of endless wrangles, increased the difficulties in running enterprises.

. . . Government organs . . . should formulate the strategy, plans, principles, and policies; work out plans for the exploitation of natural resources, for technological transformation, and for the development of intellectual resources; coordinate the development plans of localities, departments, or enterprises and the economic relations among them; arrange for the construction of key projects . . . ; collect and disseminate economic information . . . ; work out economic regulations and ordinances and supervise their execution; appoint and remove cadres within a prescribed scope . . . and so forth.

. . . The central role of cities must be brought into full play and open and interconnected economic zones of various sizes gradually formed with support from cities. . . . It is necessary to call the attention of all leading urban comrades to the need for the city governments to separate their functions from those of enterprises and achieve simpler and decentralized administration.

The relationship between socialist enterprises is first of all one of cooperation and mutual support, but this by no means excludes competition. For a long time, people used to consider competition peculiar to capitalism. . . . Competition between socialist enterprises is fundamentally different from that under capitalism, where the law of the jungle prevails . . . our enterprises are put to the test of direct judgment by consumers in the marketplace so that only the best survive.

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VII. Establish Various Forms of Economic Responsibility System and Conscientiously Implement the Principle of Distribution According to Work

. . . Enterprises must specify in explicit terms the requirements for each workpost and the duties of each worker and staff member. . . . The basic principles of this system are a combination of responsibility, authority, and benefit; the unity of the interests of the state, the collective, and the individuals; and the linking of the income of workers and staff members with their job performance. In applying rural experiences to urban areas, we must take into account the characteristics of urban enterprise. It is neither feasible nor necessary to transplant mechanically the specific measures of the rural areas.

. . . It is necessary to establish a unified, authoritative, and highly efficient system to direct production and conduct operations and management. This calls for a system of the director or manager assuming full responsibility. Party organizations in enterprises should actively support directors in exercising their authority in giving unified direction to production and operations, guarantee and supervise the implementation of the principles and policies of the party and the state, strengthen the party's ideological and organizational work in the enterprises, improve their leadership over the trade unions and Communist Youth League organizations, and do effective ideological and political work among workers and staff members. . . . We must (also) improve the system of congresses of workers and staff members and other systems of democratic management.

. . . The socialist principle of distribution according to work will be implemented more fully. . . . The differences between the wages of various trades and jobs should be widened, so as to apply fully the principle of rewarding the diligent and good and punishing the lazy and bad and of giving more pay for more work and less pay for less work as well as to fully reflect the differences between mental and manual, complex and simple, skilled and unskilled, and heavy and light work.

There has long been a misunderstanding about the distribution of goods under socialism, as if it meant equalitarianism. If some members of society got higher wages through their labor . . . it was considered polarization and a deviation from socialism. This equalitarian thinking is utterly incompatible with scientific, Marxist views on socialism. History has shown that equalitarian thinking is a serious obstacle to implementing the principle of distribution according to work and that if it is unchecked, the forces of production will inevitably be undermined. . . . Common prosperity cannot and will never mean absolute equalitarianism or that all members of society become better simultaneously at the same speed. . . . Such thinking would lead to common poverty. Only when some regions, enterprises, and individuals are allowed and encouraged to get better off first through diligent work can there be a strong attraction and inspiration to the majority of people.

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VIII. Work To Develop Diverse Economic Forms and Continue To Expand Foreign and Domestic Economic and Technological Changes

...The collective economy is an important component of the socialist economy, and we can give the collectives a free hand in running enterprises in many areas of production and construction. The individual economy now found in China is linked with socialist public ownership and differs from the individual economy linked with capitalist private ownership. It plays an irreplaceable role in expanding production, meeting the people's daily needs, and providing employment. It is a necessary and valuable adjunct to the socialist economy.

...Although international relations are complex and ridden with contradictions, international economic and technological ties are, generally speaking, very close, and national seclusion cannot lead to modernization... We have taken opening to the outside world to be our long-term, basic state policy. Practice has already yielded marked results. We must continue to pursue flexible policies.

As we open to the outside world, we shall open up even more between different areas of China itself.

IX. Promote a New Generation of Cadres and Create a Mighty Contingent of Managerial Personnel for the Socialist Economy

...Our contingent of managerial personnel falls far short (of our requirements)... We have a large number of veteran comrades in this contingent who, in the long period of hard struggle, have made great contributions... but they are getting up in years, and we can no longer ask them to continue in arduous leading posts. Our present urgent task is to promote boldy thousands upon thousands of young and middle-aged managerial personnel and take steps to train them.

The Central Committee calls for completion of the reshuffling of leadership in enterprises, especially key enterprises, before the end of 1985. In addition, plans should be drawn up and effective measures taken to train fairly soon large numbers of directors... chief engineers... chief economic managers... chief accountants... and party secretaries.

X. Strengthen Party Leadership To Ensure the Success of Reforms

... All party comrades should be in the forefront of reform, which represents the trend of our times... The vast number of cadres are not familiar with this work. Leading party and government functionaries at all

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levels have to be sober minded and give meticulous guidance. . . . Errors can hardly be avoided, but . . . once an error does occur, we must try to discover it promptly, resolutely correct it, draw the lessons, and continue to go ahead We must not try to accomplish the whole task at one stroke. All major reforms that affect the whole country will be arranged by the State Council under a unified plan. . . . Any reform involving the overall situation or one that is extensive in scope must first be approved by the State Council.

Party organizations in numerous localities and enterprises will undergo consolidation next year. Reform should be closely linked with this. Party consolidation should promote economic growth, which is an indicator of how successful it is. . . . We should actively support cadres and the masses who are keen on reform. When errors or deviations occur. . . we should adopt a policy of persuasion, criticism, and education toward the persons concerned and must not stick political labels on them. . . . We must not divide the cadres and masses by calling some people "reformers" and others "conservatives." We should have faith in comrades who fall behind the developing situation for a time, confident that they will understand things better in the course of reform.



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