

Central Intelligence Agency



Washington, D.C. 20505

DATE 4/2/87 FILE

DOC NO EA M 87-20054

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**DIRECTORATE OF INTELLIGENCE**

31 March 1987

**China: The Year in Review**

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**Summary**

Buffeted by political and economic problems--many of their own making--China's reform leaders faced a crisis as 1986 drew to a close. Party General Secretary Hu Yaobang and some of his allies in particular overreached themselves last summer and fall in pushing political reform and challenging the conservative old guard. By encouraging a more open debate on political reform in the media, they unwittingly inspired thousands of college students and workers to take to the streets of Shanghai and several other cities in December to demonstrate in favor of greater democracy. The demonstrations triggered a conservative backlash that contributed to Hu's fall from power in mid-January. At almost the same time reformers began to encounter increasing economic problems (pent up inflationary pressures, a ballooning state budget deficit, increasing state enterprise losses and a foreign exchange shortage) that have forced Chinese leaders to slow the pace of reform and have generated strong pressures from conservatives to retrench further.

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This memorandum was prepared by  Office of East Asian Analysis. Information available as of 31 March 1987 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Political Assessments Branch, China Division, OEA,

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Thus far, the heightened infighting between reformers and conservatives has not spilled over into the conduct of China's foreign policy. Indeed, Beijing probably will continue to seek better relations with both Moscow and Washington with the aim of enhancing China's security and bolstering its modernization drive. In response to Gorbachev's efforts to court Beijing, the Chinese increased political as well as economic contacts last year with the Soviets, and even agreed to resume Sino-Soviet border talks that had been suspended since 1978. But on balance, China continues to maintain friendlier relations with the United States, exemplified by deepening military ties which included last fall's US naval port call to China--the first since the present government took control. [REDACTED]

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### Domestic Politics

China's reformers were riding high early last year after scoring a number of impressive victories over their conservative opponents. But a combination of political miscalculations and economic problems have subsequently sapped the political strength of the reformers and slowed the pace of reform. The early hopes of some of the most progressive reformers that major political reforms would be undertaken have evaporated in the face of strong resistance from party elders and the fall from power of Party General Secretary Hu Yaobang. [REDACTED]

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Friction between conservatives and reformers mounted throughout 1986 over a broad range of issues--political reform, ideology, economic policy, succession arrangements, even dispensing patronage jobs. During the spring, reformers appeared to be in firm control. A massive propaganda campaign encouraging open debate on political as well as economic reform led to the discussion of a number of radical ideas in the Chinese press--even suggestions that Marxism was no longer a suitable guide for China's modernization drive. Conservatives also became the target of a campaign against corruption that reformers controlled and used to threaten their rivals. [REDACTED]

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The period of reformist dominance was brief, however, and signs of a conservative counterattack began to appear by early summer. Discussions of political reform began to appear less frequently and those that appeared were watered down. We believe the reformers overreached themselves, miscalculating the strength of the conservatives and badly underestimating the alarm and opposition that aggressive reform policies would arouse. The crucial miscalculation apparently occurred in late summer, when Hu Yaobang pressed Deng and other party elders to step down, and make room for their successors--including, of course, Hu. [REDACTED]

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Issues of both policy and power separated the two camps:

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- **Party control** was at the heart of many specific policy quarrels. Conservatives feared, and we believe convinced Deng, that reform proposals threatened the party's dominance and even its ability to guarantee political and social stability.
- **Ideology** became an increasingly contentious area, with conservatives arguing that some reformist suggestions, for example ownership reform in industry, not only would weaken party control but were an unacceptable departure from socialist doctrine.
- Disagreements over **succession arrangements** heated up as Deng lost confidence in the younger leaders. Party elders, reluctant to give up their positions, worked to persuade Deng that it would be unwise for him to step down.
- **Personnel appointments** were also a source of friction; conservatives resented Hu's success in monopolizing patronage and freezing out their supporters. [redacted]

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Conservative criticism of reform policies was given a boost by two events. First, reformers encountered a number of problems in the economic area--inflation, a growing budget deficit, foreign exchange shortages--that forced a slowdown in implementation of economic reforms. Some of these problems conservatives had warned against, which lent weight to their arguments that reform has moved too fast and it was time to retrench. Second, the student demonstrations in December that were encouraged by the liberal rhetoric of the spring aroused fears of instability. Hu Yaobang's tolerant attitude toward this dissent added to conservative dissatisfaction with him--and also to Deng's loss of faith in his protege. [redacted] Hu was criticized and finally forced to resign. Premier Zhao Ziyang was chosen Acting General Secretary to replace him. [redacted]

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Since Hu's fall, there has been a marked conservative shift in China. We believe the decision to oust Hu was Deng's and he did not act under duress, but it is clear that conservative elders have regained considerable power. This is demonstrated not only in the emergence of traditionalist themes in propaganda, but also in growing conservative influence over personnel appointments, party matters, and even economic policy. Deng and Zhao appear to be working to limit the effect of the conservative backlash on core economic reforms, but the new strength of the conservatives was recently demonstrated when they blocked a move to increase the authority of factory managers at the expense of the party committees. With Hu out of office only two months, new power alignments are still unclear and probably in flux. We look for the next several months to be a period of political tensions and jockeying for power as all sides prepare for a scheduled party congress in October. [redacted]

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### Foreign Policy

As long as Deng Xiaoping remains in charge we do not expect any sudden, dramatic changes in the thrust of China's foreign policy. Deng and Zhao in fact have

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[redacted]

already gone to some pains since Hu Yaobang's ouster to reassure Western governments and investors on that score. In general we believe China will continue to tout its "independent foreign policy" line while seeking better relations with both Moscow and Washington. However, some adjustments could occur, particularly in the open door policy, as a result of the resurgence of conservative influence in the Chinese leadership. [redacted]

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Despite Gorbachev's increased efforts to court Beijing, Chinese leaders probably will continue for both economic and security reasons to seek closer ties with the United States. Indeed, Beijing still regards the United States as an important strategic shield against Soviet military pressure as well as a key market for Chinese exports and source of investment capital and technology. No single element better illustrates the qualitative difference between Sino-Soviet and Sino-US relations at present than the deepening military ties between Beijing and Washington. Over the past few years senior Chinese and US military officials have exchanged numerous visits. Last year was marked by several particularly important events, including the exchange of visits by China's Chief of General Staff and Secretary of Defense Weinberger. China also contracted to purchase 55 fighter avionics packages for \$500 million and \$2 million worth of artillery-locating radars. [redacted]

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The resurgence of conservative influence, however, may have some influence on Sino-US economic relations. Beijing, for example, could adopt a more selective approach to joint venture schemes with Western firms as well as a more restrictive policy toward allowing Chinese students to study in the West. The Chinese may also turn more to the Soviets and East Europeans for some equipment and services, in part to save scarce foreign exchange, and become more prickly in general on trade issues. The conservatives could conceivably press for some retaliatory action, for example, if the US Congress enacts strong protectionist measures that cut Chinese textile exports to the United States--an increasingly important earner of foreign exchange in the wake of declining oil prices. The conservatives could also seize on the sharp drop in new foreign investment last year--US investment alone dropped by about half--to attack some reform policies. [redacted]

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Paradoxically, impending streamlining of COCOM procedures for China--while previously important politically as well as economically to reformers--probably will have little impact. Short-term Chinese demand for Western technology in fact will probably level off or decline because of China's present foreign exchange crunch and because China is having difficulty absorbing the sophisticated Western technologies it already has. In any event, the COCOM changes will not significantly increase the US share of China's high-technology market unless accompanied by concessionary prices and/or financing. [redacted]

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Meanwhile, we expect Sino-Soviet trade and scientific and technical exchanges to increase. Trade in 1986 shot up to an estimated \$2.4 billion and the Soviets have agreed to renovate 17 Chinese factories and construct seven new facilities--most in northeastern China--that probably will lead to several hundred Soviet technicians going to China. Overall, however, the Soviet Union remains a distant sixth among China's trading partners, well behind Hong Kong, Japan, the United States and West European states which continue to account for over 80 percent of China's trade. [redacted]

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Although the political dialogue has similiarly expanded to include border talks (suspended in 1978), the Chinese continue to take a cautious approach to Soviet overtures--in part to avoid alarming the United States and its Western allies as well as Japan. As a result, they continue to emphasize the need for Moscow to adopt more accommodating policies on the so-called "three obstacles"--Moscow's support for Hanoi's occupation of Cambodia, the Soviet invasion of Afghanistan, and the Soviet military buildup along China's northern border--which Beijing continues to define as threats to its security. The Chinese remain particularly adamant that Moscow withdraw its support for Vietnam's continued occupation of Cambodia. At the same time they continue to provide support for the Cambodian insurgents as well as the Afghan rebels as a means of keeping the Soviets and their allies in notice. The Chinese also continue to press Washington to initiate a dialogue with North Korea in order to limit Moscow's ability to exploit tensions on the peninsula. 

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