



Directorate of Intelligence

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China: Can Large Arms Sales Be Sustained?

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An Intelligence Assessment

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This paper was prepared by [Redacted]
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China: Can Large Arms Sales Be Sustained?

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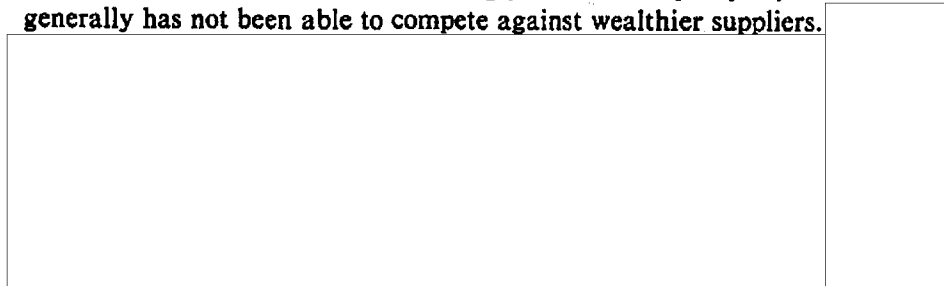
Key Judgments

Information available as of 31 March 1987 was used in this report.

China is unlikely to maintain its position as the world's sixth-largest arms supplier if the Iran-Iraq war ends. Since embarking on a full-scale arms export campaign in the early 1980s, Beijing has averaged almost \$1.5 billion in arms sales each year, with Baghdad and Tehran accounting for 75 percent of sales. We believe this war-driven market is unlikely to last: both countries are interested in reequipping their armed forces with better Western or Soviet Bloc equipment. We also believe that China is unlikely to find other customers in the short to medium term to make up for the expected postwar decline in sales to Iran and Iraq. Most large or relatively professional Third World militaries will remain uninterested in Chinese weapons, which are considered technologically inferior to Soviet or Western equivalents.

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Beijing almost certainly recognizes the transient nature of the Iran-Iraq market and is trying to attract new customers to China's easily operated and serviced weapons. China is offering economic incentives—such as financing and coproduction—increasingly demanded by buyers, but it generally has not been able to compete against wealthier suppliers.



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In view of the contraction in the global arms market in recent years because of growing arms inventories, mounting LDC debt, and declining oil revenues, we believe China's hard currency earnings from arms exports will decline over the short term. This decline may constrain China's ability to purchase US or Western arms or production technology and slow the pace of the military modernization of Chinese forces along the Sino-Soviet border. Short-term pressures on China might be reduced if nations dependent on the USSR for arms turn to China for spare parts or replacement weapons.

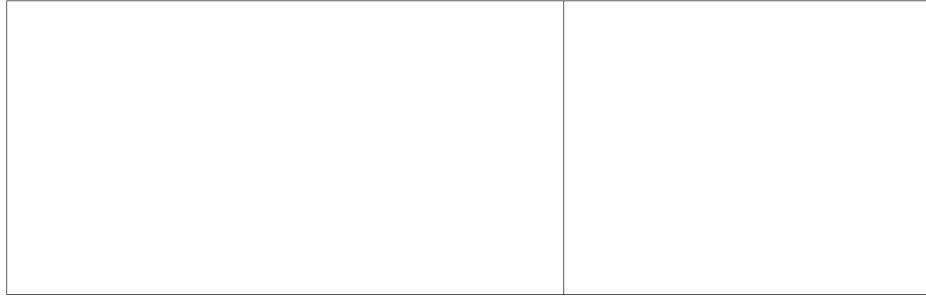
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China: Can Large Arms Sales Be Sustained? [Redacted]

Introduction

(b)(1) Between 1980 and 1982, China emerged as the
(b)(3) world's sixth-largest arms supplier (after the USSR, the United States, France, the United Kingdom, and West Germany), largely on the strength of sales to Iran and Iraq. [Redacted]

(b)(1) [Redacted] This paper analyzes the source of the strengths
(b)(3) and weaknesses in China's sales of arms to the Third World and evaluates China's potential to compete in the tight international arms market in the aftermath of the Iran-Iraq war. It also assesses China's longer term prospects as an arms exporter [Redacted]

1980s Arms Sales: A Booming Record

(b)(1) China's emergence as a major arms seller in the 1980s
(b)(3) stems from a decision made in 1979 to enter the international arms market to earn hard currency. This decision—taken as a part of Deng Xiaoping's modernization drive [Redacted]

(b)(1) signaled Beijing's move away from political factors as
(b)(3) the primary motive for Chinese arms exports. Until then, China's arms sales and grant military aid had focused on strengthening strategic neighbors like Pakistan and North Korea. [Redacted]

arms sales would generate sufficient hard currency to help modernize the armed forces with Western arms and technology. Beijing sought to take advantage of the increase in Middle Eastern arms purchases that accompanied rising oil prices, but most of the oil-rich countries initially rejected China's weapons in favor of more sophisticated Western or Soviet arms. [Redacted]

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Figure 2. More than 2,000 tanks have been sold to Iraq

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China's opening into the lucrative Middle Eastern market came in 1980, immediately following the outbreak of the Iran-Iraq war, as a result of Soviet refusal to sell major military equipment to Iraq. Chinese equipment helped Iraq withstand repeated Iranian ground offensives.

Iraq received more than 70 percent of China's estimated worldwide arms exports in 1981 and 1982 during this period Iraq contracted for more than 2,000 Chinese tanks, enough to replace most of its losses (figure 2). Chinese deliveries of more than 1,000 armored personnel carriers (APCs) were sufficient to replace an estimated two-thirds of Iraq's APC losses. Baghdad also received large quantities of field artillery, air defense artillery, and ammunition.

During the 1983-85 period, Iran gradually replaced Iraq as Beijing's primary customer. During that time, the USSR and Eastern Europe resumed their prewar

position as Baghdad's major arms source, and China signed no large new deals with Iraq. Tehran, for its part, purchased large quantities of Chinese ammunition and artillery through North Korean and other intermediaries, replacing Iraq as China's largest customer. We believe Tehran accepted Chinese offers because Iran desperately needed consumables, such as small arms and ammunition, to continue the war.

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Arms sales to countries other than Iran and Iraq fell during this period and have continued to decline, despite Beijing's attempts to attract new customers.

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During the last two years, China was able to make more sales to Iraq and Iran as Baghdad resumed purchases of Chinese equipment and materiel, and Tehran added to its purchases by buying major

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Figure 3. HQ-2 (SA-2) surface-to-air missile of the type sold to Iran in 1985.

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Chinese equipment for the first time. We estimate Iraq signed contracts worth more than \$1 billion in 1986. China's large sales to Iran apparently resulted from Beijing's decision [redacted] to deal with Iran directly. These orders from Iraq and Iran came as new Chinese contracts with other customers dwindled to almost insignificant levels. [redacted]

(figure 3). The limited quantities of HQ-2s delivered to Iran will not seriously impede Iraqi air attacks on vital oil terminals and refineries, in our judgment,

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Chinese weapons and ammunition helped Iran and Iraq continue the war, and recent deliveries have enhanced Iranian capabilities. [redacted]

Limitations Through the Early 1990s

In the near term, China is likely to face serious limitations in its effort to sell more arms in the Third World. China's large sales volume so far in the 1980s has resulted primarily from Iraq's, and more recently Iran's, need for inexpensive, easy-to-use weapons. Without large Iranian and Iraqi purchases, we believe Chinese arms sales will be significantly reduced until at least 1990 by a limited customer base, inferior technology, and marketing weaknesses. [redacted]

Since late 1985 we have confirmed at least \$1 billion in sales to Iran: a [redacted] deal in 1985 for HQ-2 surface-to-air missiles, antiship missiles, field artillery, and ammunition; and up to [redacted] in sales in 1986 for various weapons systems and ammunition

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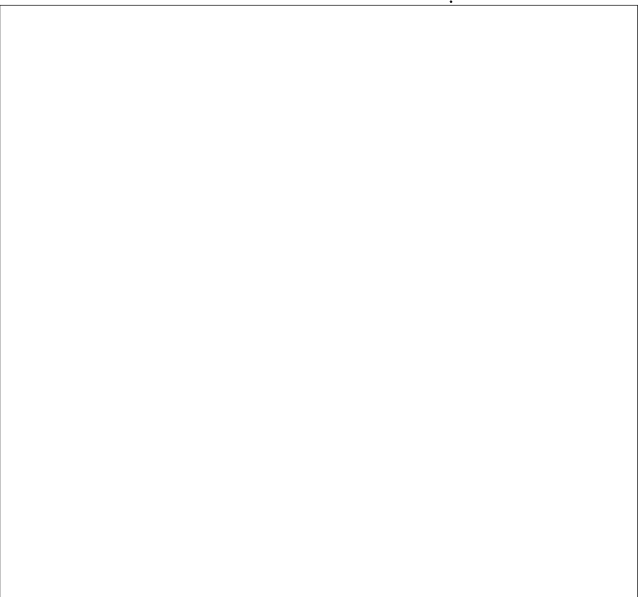
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Limited Customer Base

The lack of a reliable and extensive customer base will make it difficult for China to maintain its current level of sales. The number of nations buying arms from China has declined over the last four years—some customers in the early 1980s proved to be one-time buyers, and several first-time customers in the last three years are unlikely to make additional purchases.



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In our view, Iraq is unlikely to continue buying such large amounts of Chinese arms even if the war drags on. We believe Baghdad only turned back to Beijing in 1986, after three years of minimal purchases, because reduced income from falling oil prices had made the inexpensive Chinese weapons more attractive. The even larger purchases of weapons and munitions from the USSR, however, indicate Baghdad's continuing preference for Soviet equipment. When the war ends, Iraq is likely to resume its late 1970s' effort to improve its armed forces with up-to-date Western and Soviet Bloc equipment.

Inferior Technology

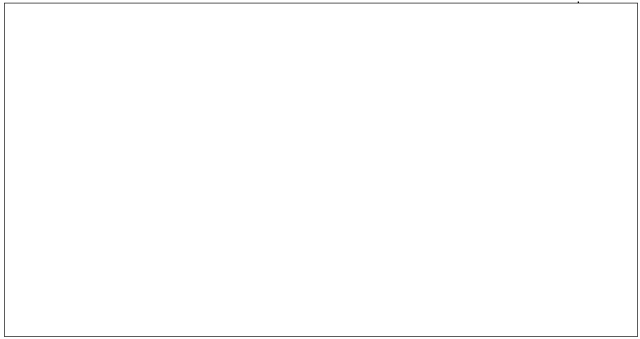
China's arms sales to large or relatively professional Third World militaries will be limited by the widespread and largely correct perception that Chinese weapons are technologically less sophisticated than Western and Soviet exports:

- Most Chinese weapons are based on Soviet designs and technology of the 1950s.

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Iran is more likely to continue its large purchases from China, and Beijing is trying to arrange more sales—possibly including tanks, fighter aircraft, and air-to-air missiles. We believe Iran's purchases are not likely to equal the scale of Iraq's past purchases, however, either during or after the war:

- Tehran's war strategy is based on infantry-artillery offensives that do not require large quantities of equipment other than artillery, munitions, and small arms.
- After the war, we believe that the Iranian military will seek higher technology non-Communist equipment and that a number of suppliers will be available.



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One consequence of the dated technology in Chinese weapons is the low demand for Chinese training and maintenance support, which will further weaken Beijing's market position. Other large suppliers use Third World military training in the supplier country to keep customers dependent on the supplier for spare parts and follow-on support after an initial sale.

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[Redacted] Even if China were to offer licensed production to other customers, it would be refused, in our view, because few countries can benefit from purchases of dated Chinese production technology.

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China's marketing efforts remain amateurish when compared with those of more established suppliers, which will hurt Beijing's sales in the highly competitive marketplace.

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[Redacted] China does not hesitate to offer training on its more sophisticated systems, however; more than 100 Iranians trained in China on antiship missiles in 1985.

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Marketing Weaknesses

China's limited financial resources and emphasis on earning hard currency through cash sales place it at a significant disadvantage in an increasingly competitive Third World arms market.

China is taking steps to attract new customers by improving its marketing, but it is still not ready for the showy marketing arena of the large Western suppliers:

- Beijing hosted its first international arms exhibition in November 1986, which featured China's newest equipment along with personnel to discuss the capabilities of the equipment and sales.

[Redacted] Beijing has been slow to adopt creative financing practices, provides very little military aid, and shows few signs of being able to compete effectively with other major suppliers.

Many Third World nations are seeking licensed production agreements to reduce the foreign exchange cost of arms purchases and to gradually decrease their dependence on foreign weapons suppliers. Most major suppliers, including the USSR, are responding to this demand to garner sales and protect their markets; but China is largely absent from the coproduction picture.

China's direct sales pitches to governments are also flawed.

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Prospects for the 1990s

We believe China recognizes the need to develop a market for its weapons beyond Iran and Iraq, and the steps it is taking now to attract new customers may enable it to maintain a moderate level of sales in the 1990s. China, for example, is developing new equipment—much of it specifically designed to meet customer requirements—and is seeking to incorporate Western technology into its weapons. China enjoys several comparative advantages that may further bolster arms sales in the 1990s, if the technology lag can be bridged. The key to China's future success, in our judgment, is its ability to market its improved products in an increasingly competitive marketplace. If China is unsuccessful in its attempts to produce and

sell major weapons based on Western technology, the prospects for increased arms sales are not as optimistic. [redacted]

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Overcoming Technological Inferiority

China is seeking several ways to overcome the most important drawback to increasing arms sales—the technological inferiority of its weapons. We believe Beijing is producing NATO-standard weapons and ammunition and is reconfiguring current weapons to meet customer requests. [redacted]

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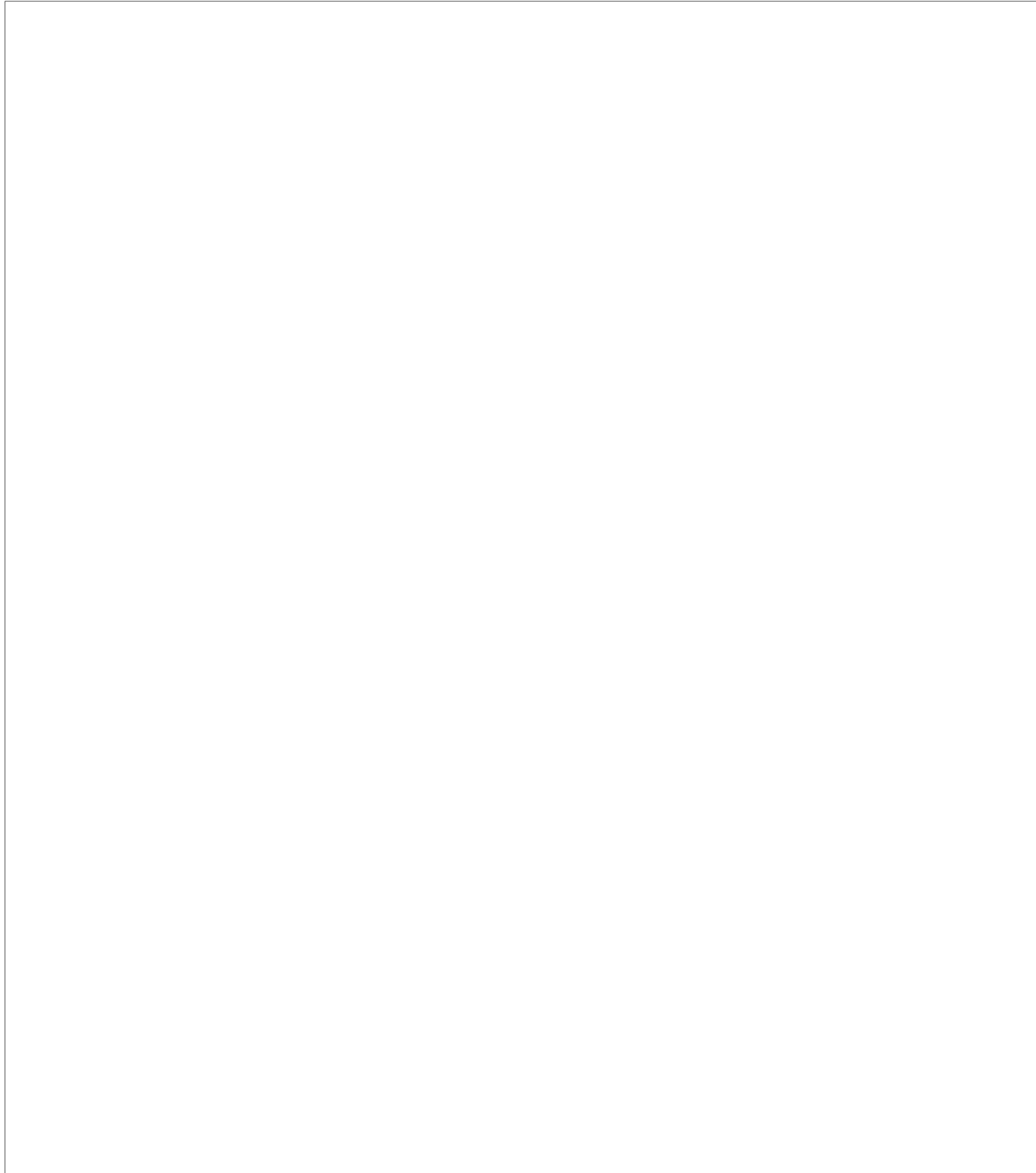


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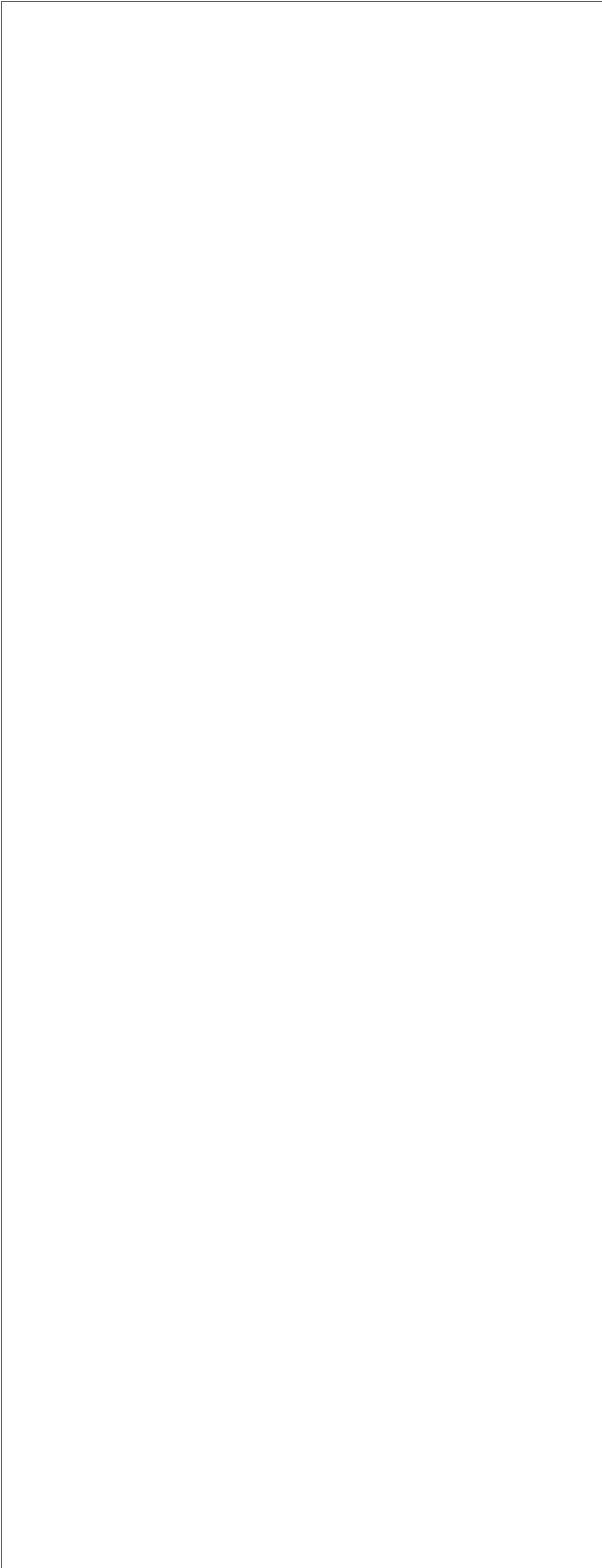
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Low-Cost, Easy-To-Use Weapons

China probably will continue to maintain a moderate level of arms sales based on its traditional strengths. Relatively unsophisticated, small military forces in the Third World find Chinese weapons attractive because of their simplicity and low price. As with Soviet weapons, training is not complicated, and personnel with limited basic or technical education can learn to operate Chinese weapons easily and quickly. [redacted]

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We believe China's potential market will continue to include all LDCs that have purchased weapons from the USSR or its allies. Most of China's weapons and ammunition types are identical to, or derived from, Soviet models, and most of its sales have been made to LDCs [redacted] that have purchased Soviet weapons [redacted]

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[redacted] many Third World countries still want to diversify their source of arms. Some nations may purchase arms from Beijing to make Moscow more forthcoming with equipment or financing. In cases where Moscow and a client government have a falling out, Beijing may have opportunities for more significant sales. [redacted]

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Beijing has also made a place for itself by providing spare parts and technical assistance for Soviet equipment. China produces parts for its own inventory of weapons based on Soviet designs and can provide parts for a wide variety of older Soviet equipment. [redacted]

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If China is to maintain or expand its current sales volume, it must overcome several factors that will constrain the arms sales of all suppliers to the Third World over the long term. All of these factors, taken together, have already led to a contraction in the Third World arms market of at least 20 percent since 1982, and a repetition of the boom years for the international arms trade in the late 1970s and early 1980s is unlikely:

- Many Third World nations purchased their first major weapons systems—jet combat aircraft, warships, and armored vehicles—in the last decade, and other, larger LDC militaries completed major expansions and modernizations of their inventories at the same time. We judge that many LDCs will make no major weapons purchases until at least the early 1990s, when another more modest modernization cycle will begin to replace arms purchased in the 1970s.
- Falling oil prices since 1982 have also reduced sales to the Middle East as well as to other oil-producing states. Only a significant rise in oil prices would rekindle strong demand in the 1990s.
- Falling commodity prices in general have reduced export earnings for many nonoil producing, less developed countries, thereby reducing their ability to buy arms.
- Rising LDC foreign debt burdens, in part a result of falling commodity prices and previously ambitious import schemes, have forced sharp cutbacks in LDC imports of many goods, including arms. Many LDCs are likely to face debt-imposed import limitations well into the 1990s.
- Many Third World nations are slowly developing indigenous defense industries. This trend is likely to continue as LDCs try to reduce their dependence on foreign arms suppliers and the foreign exchange cost of importing arms. Indigenous Third World production will reduce the export market and provide more competition for China in its areas of strength— inexpensive, relatively unsophisticated weapons and ammunition.

- The equipment China is developing today for export will face stiff competition from other Third World suppliers. Brazil produces the highly successful Tucano trainer aircraft, armored vehicles, and a wide range of other equipment that competes directly with Chinese armament. Other emerging suppliers, such as Singapore and South Africa, will also be anxious to make sales.

We believe China's effort to develop both higher quality and more widely demanded weapons while maintaining low prices gives it a better-than-even chance of selling at least \$1 billion of arms annually in the 1990s. Beijing's potential ability to supply inexpensive weapons with few political strings attached will give it an advantage over large arms suppliers marketing costly high-technology items. In addition, Beijing's ability to produce large quantities of arms quickly will give China an edge over smaller nations that can only produce in small quantities. Only China's inability to or lack of interest in offering attractive financing or licensed production packages will remain serious constraints to its 1990s' market position.

Implications(b)(1)
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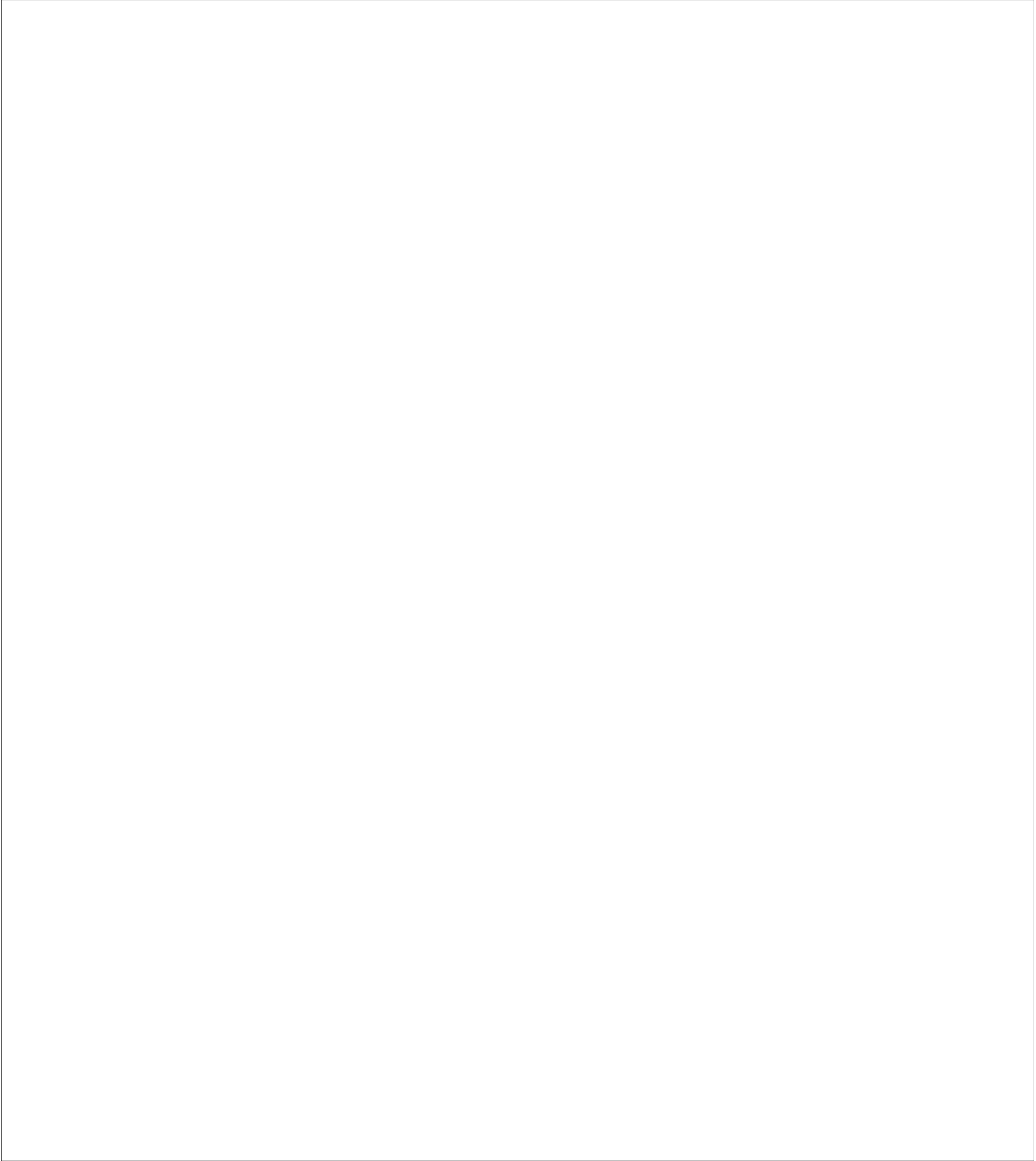


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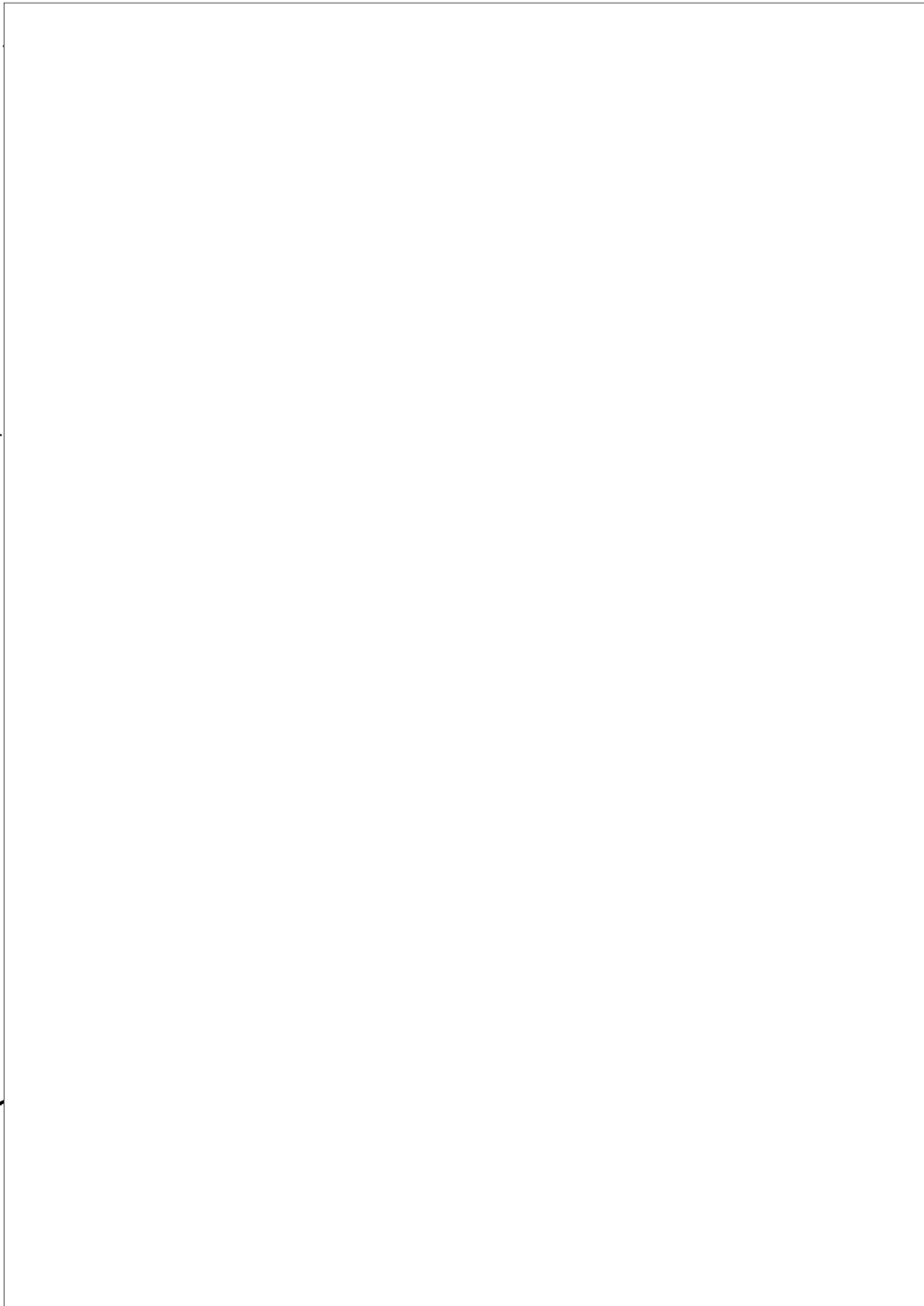
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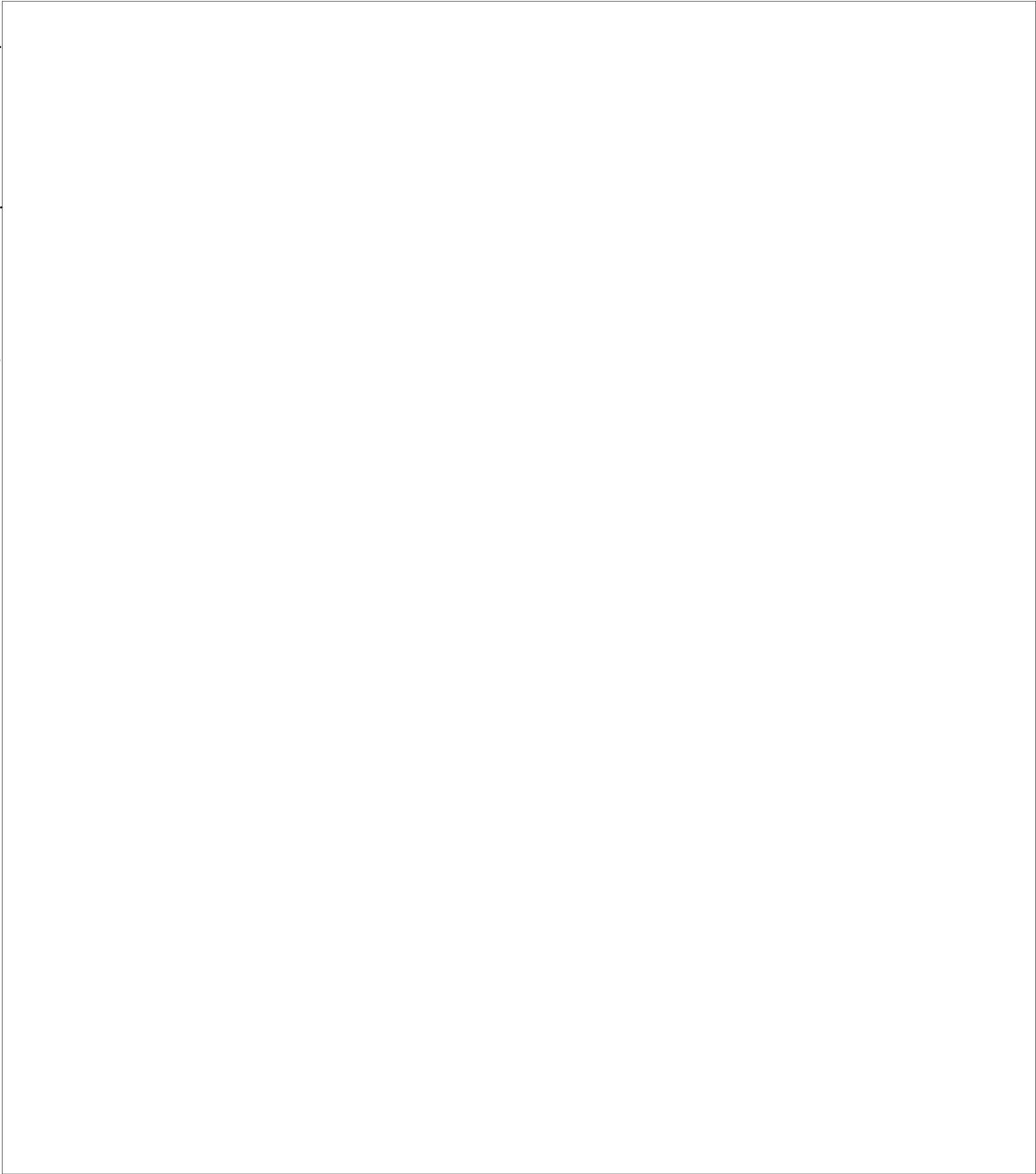
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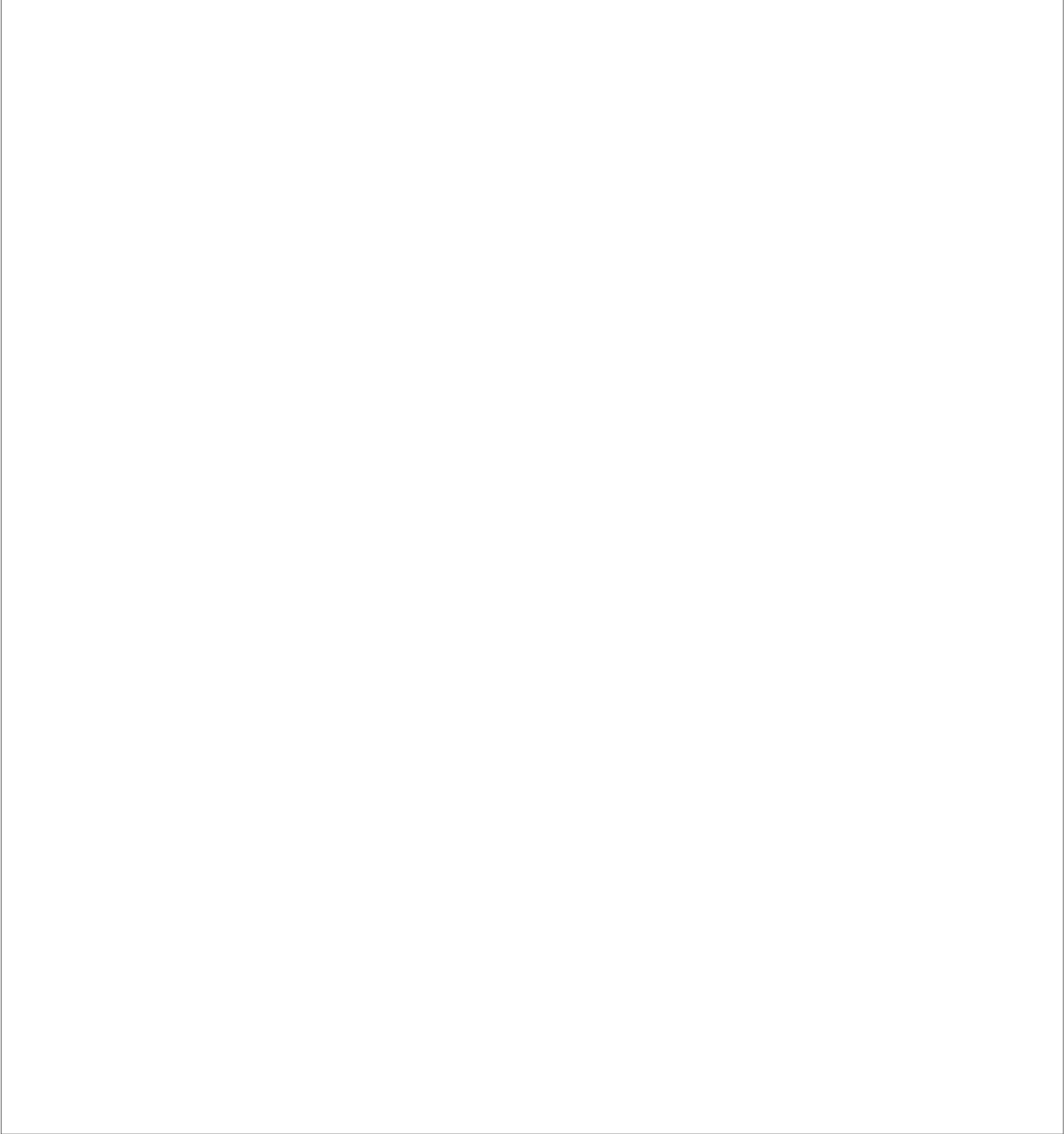


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