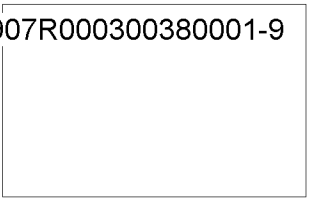


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Central Intelligence Agency



Washington, D.C. 20505



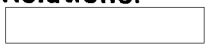
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DIRECTORATE OF INTELLIGENCE

12 August 1987

**Sino-East European Economic Relations:
Moderate Growth Expected**

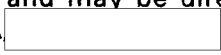


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Summary

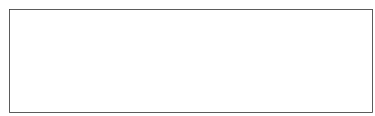
China's economic ties with Eastern Europe have grown rapidly in recent years and will probably continue to strengthen over the near term. The expansion in bilateral trade, which has more than doubled since 1983, is based on both partners' desire to barter for goods rather than expend foreign exchange, as well as on the attractiveness of the respective markets--a huge potential for East European sales in China, and a market in Eastern Europe for lower quality Chinese goods that cannot be sold in the West. Bilateral scientific and technical ties have also mushroomed, covering new areas of high technology with agreements extending over longer periods. Boosted by both Chinese and East European desires for closer political relations and by the complementary nature of their economies, we expect S&T relations to continue strong over the next decade and trade to increase at a more modest pace at least through 1990. The warming in relations will not have a direct impact on the

This memorandum was prepared by the Trade and Technology Branch, China Division, Office of East Asian Analysis. Information available as of 1 August 1987 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Trade and Technology Branch, China Division, OEA



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United States unless China attempts to use it to press for more barter and countertrade with US firms. Problems could also arise if China transfers controlled Western technology to the Bloc, but we are reasonably confident that China will transfer at most some of the know-how it has gained through exposure to the West and will not knowingly retransfer controlled hardware. [redacted]

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Revived Economic Relations

China has expanded trade with Eastern Europe in the 1980s despite a chronic trade deficit with the region. Although it remains only 5 percent of China's total trade, according to Chinese statistics, trade with Eastern Europe jumped from \$1.6 billion in 1983 to \$3.5 billion last year¹ (see figure). In 1985, Beijing signed five-year trade agreements--generally calling for trade on a barter basis--with all East European countries. [redacted] China exports raw materials, consumer goods, and light industrial goods in exchange for motor vehicles and industrial equipment needed to modernize its factories. [redacted]

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China also has broadened the scope of cooperative S&T projects under existing bilateral agreements with East European countries, signed new accords involving a wide range of Chinese and East European organizations, and permitted ad hoc arrangements between Chinese and East European enterprises to expand (see appendix B). Under annual bilateral protocols started during the 1950s--which resumed in 1974 after a hiatus during the 1960s--Chinese and East European scientists are cooperating in more than 300 projects. [redacted] Joint projects in the last two years alone have roughly equalled the number underway during the entire preceding decade. In addition, official press releases reveal that Chinese and East European researchers are exchanging scientific literature, attending conferences, and working on joint projects under a growing number of accords signed outside the formal protocol mechanism. The Chinese Academy of Sciences last year, for example, signed agreements with the Bulgarian, East German, and Hungarian Academies. [redacted]

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Many of these new agreements are long-term; agreements with East Germany and Bulgaria, for example, extend through the year 2000, and China has signed five- or 10-year agreements with Poland, Romania, Czechoslovakia, Bulgaria, and Hungary. Because many of the longer term agreements have been signed only recently, we do not know how much--or even if--they will influence the scope and nature of scientific cooperation. Nonetheless, we believe they are symbolically significant, and imply a commitment on both sides to improved relations in the 1990s. [redacted]

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¹ Except as otherwise noted, all statistics in this paper are based on Chinese Customs data. [redacted]

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Sino-East European Trade Relations at a Glance

Poland now ranks second only to the Soviet Union among China's socialist trading partners and is China's ninth largest foreign market. Total trade has nearly doubled in each of the last two years, and reached \$1 billion in 1986. Poland supplies China with industrial machinery, cars, trucks, buses, power industry equipment, machine tools, construction machinery, and a wide variety of steel products and chemicals. China ships Poland supplies for agriculture and food industries and under the newest bilateral trade agreement will supply nonferrous metals, chemicals, car tires, raw cotton, textiles, basic food items such as soybeans, corn, and rice, and a variety of consumer goods.

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Trade with **Romania**, China's second largest East European trading partner, did not meet Chinese expectations last year. Although the 1986 trade protocol called for an increase of 40 percent over 1985, trade actually increased only 5 percent. Romania supplies China with iron and steel, fertilizer, machinery, and vehicles. China exports coal, textiles, and machinery. China's trade deficit with Romania was the largest among East European countries last year, reaching \$290 million.

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Czechoslovakian trade with China increased nearly 40 percent in 1985, but slowed to a 15-percent increase in 1986. China shipped apparel, textiles, and food products while importing vehicles, iron, steel, and machinery.

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Chinese statistics indicate that trade with **East Germany** rose 73 percent in 1985 and another 27 percent last year. China shipped clothing, textiles, and grain, while buying vehicles, iron, steel, and machinery.

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Trade with **Hungary** accounted for only 10 percent of China's trade with Eastern Europe in 1986, but has been growing rapidly, doubling in 1985 and increasing 75 percent last year. According to the US Embassy in Beijing, trade still did not reach the level projected in the 1986 protocol. Trucks and other motor vehicles represent a major share of China's imports from Hungary.

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Yugoslavia is the only East European country with which China conducts most trade on a cash basis. As Beijing's concern about its hard currency position has grown, trade with Yugoslavia--which has consistently produced a deficit for China--has become increasingly unattractive. Although the Yugoslav press projected that bilateral trade would double in 1986, Chinese statistics show it dropping by more than 20 percent.

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Trade with **Bulgaria** accounted for only three percent of China's trade with Eastern Europe last year. China exchanges its consumer goods and textile machinery for Bulgarian food-processing equipment, metals, and chemicals.

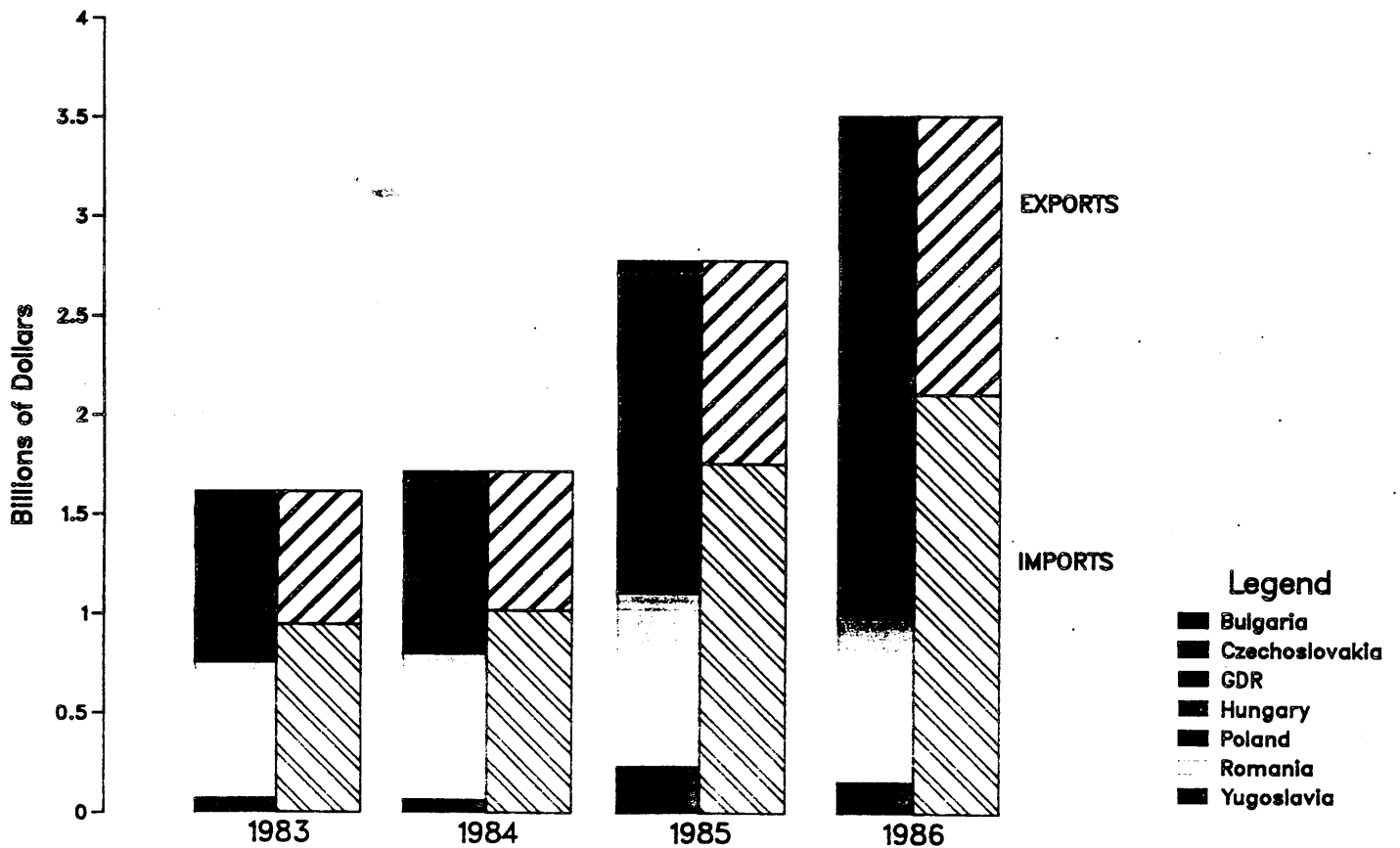
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China's Trade With Eastern Europe, 1983-86



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Technical cooperation in industry has also grown markedly; Chinese ministries have signed agreements with their East European counterparts in such areas as electronics, telecommunications, coal mining, and geology. Independent technology-sharing arrangements have developed between individual factories as well.

[redacted] last year China's central trade corporations signed technology contracts with Poland, East Germany, Bulgaria, Hungary, and Czechoslovakia worth \$270 million--roughly 6 percent of total technology purchases, according to Chinese Ministry of Foreign Economic Relations and Trade statistics. [redacted]

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The Evolving Political Relationship

In support of the expanding economic relationship, political ties have also begun to warm, albeit under the watchful eye of the Soviet Union. In 1983 China took its first cautious step toward the reestablishment of Sino-East European party relations when it addressed East European socialists as "comrades" and sent two middle-ranking Foreign Ministry officials to Poland, East Germany, Bulgaria, Czechoslovakia, and Hungary. The relationship blossomed in 1985 with the restoration of political relations at the vice-premier level and the revival of parliamentary and trade union links. In the past three years, both the number of exchanges and the rank of officials travelling have increased steadily [redacted]

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Since last fall China has been visited by Poland's Communist Party First Secretary Jaruzelski, East German party General Secretary Honecker, Czech Premier Strougal, Bulgarian party General Secretary Zhivkov, and by deputy prime ministers from Hungary and Romania. Although China has maintained official party relations with only East Germany and Romania, the distinction between party and state has gradually blurred in relations with the other East European countries. For instance, East European leaders have often been referred to by their party titles while visiting high-ranking Chinese party officials. The June 1987 visit of Premier and Acting Party General Secretary Zhao Ziyang to Eastern Europe in effect cemented the party-to-party ties with Czechoslovakia, Hungary, and Bulgaria. [redacted]

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What Beijing Wants

We believe that Beijing looks to Eastern Europe for trade and technology largely because it considers barter trade a way to acquire basic technology and equipment without outlays of scarce foreign exchange. Goods manufactured in Eastern Europe also tend to be less expensive than Western items. Additionally, the Chinese can sell Eastern Europe goods that because of inferior quality could not compete on the international market, as well as items restrained by Western import barriers. [redacted]

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Beijing apparently also expects to learn from some of the more technologically advanced East European countries. Recent bilateral agreements have included high-tech topics--such as semiconductors, data processing, materials research, space technology, genetic engineering, nuclear power, and telecommunications--as well as more traditional areas such as heavy industry, energy, and transportation. Although China is also seeking Western technology, we believe that Beijing seeks East European assistance to compensate for technologies China cannot acquire because of export controls.

Beijing, for example, has sought Yugoslav assistance in linking US minicomputers into a nationwide network; US and multilateral export controls for China permit sales of the computer hardware but limit transfers of data networking know-how.

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Political considerations have also been a factor in China's encouragement of closer economic links to Eastern Europe. According to Embassy reporting, Beijing wants to increase its influence in the region--and reduce that of the Soviets--by becoming an alternative market for East European equipment, and by providing an alternative model for economic reform.

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And What China Has to Offer

Political factors have been an important motive for Bloc countries to boost their economic ties to Beijing. The Soviet Union, for example, plays an active role in encouraging East European countries to improve relations with China. Several of the recent meetings between Chinese and East European officials have been either preceded or followed by consultations between Soviet and East European officials. According to Embassy reporting, Hungarian officials have said that the Soviets are encouraging closer Sino-East European ties to help Moscow improve its relations with Beijing.

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In addition, the East Europeans view China as a potentially huge market, and shortages of hard currency make barter trade for Chinese raw materials and textiles extremely attractive. Moreover, we believe that some East European countries have encouraged S&T ties to China because they expect the technology flow to be in their favor. Bulgaria and Czechoslovakia, for example, have been favorably impressed with China's electronics capability. Most East European countries have much to learn from China's experience with the sophisticated Western technology in many of its research and production facilities; all but Yugoslavia are subject to more stringent Western export controls than China.

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Looking Ahead

There are limits on the expansion of Sino-East European relations. Eastern Europe, for example, must satisfy its obligations to the Soviet Union before allocating resources for trade with China. In addition, the Chinese are unable to use all of the East European products. A large portion of East European sales, for example, are vehicles, on which China has placed an import ban because of oversupply. On the political side, Moscow would probably rein in Sino-East European relations if they become too rosy, or

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if they fail to lead to improved ties between Moscow and Beijing. The US Embassy in Warsaw reported that, according to a knowledgeable Polish source, increased Sino-Polish cooperation is deeply troubling to the Soviets, who count the number of articles about China in the Polish press. [redacted]

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On balance, we believe China's S&T relations with Eastern Europe will expand more rapidly than bilateral trade. Clearly, the growing number and duration of bilateral agreements as well as the inclusion of high-tech topics in joint research and industrial cooperation projects indicate a commitment on both sides to closer S&T ties well into the 1990s. Despite the advantages of barter trade and the generally complementary nature of their economies, we believe bilateral trade will expand over the near term at a much slower rate than in recent years. The volume of trade for this year may even show a slight decline in value terms [redacted] because of the decline in price of raw materials and primary products, the decrease in Chinese purchases of autos and machinery, and the decrease in East European purchases of textiles and light industrial goods. But, because of the agreements China has signed with the region, annual trade should average slightly more than last year's volume between now and 1990. [redacted]

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Regarding specific country accounts, we believe China's trade will continue to expand with East Germany, Poland, and--from a much smaller base--with Yugoslavia:

- China and **East Germany** are actively cultivating the bilateral relationship, and [redacted] East Germany must be given special attention because it is the most technically advanced of China's East European trading partners. East Germany reportedly is seeking areas for cooperation--especially in scientific research--that will demonstrate that cooperation can be productive.
- According to the **Polish** press, the 1987 trade protocol with China calls for maintaining the current high level of trade. The protocol also calls for wide Polish participation in industrial modernization and development projects in China. Polish Vice Premier Wladyslaw Gwiazda has publicly stressed the importance of importing technologically advanced machines and equipment from China.
- **Yugoslavia's** responsiveness to Chinese concerns over the trade imbalance and resultant drain on hard currency--it has increased imports and is encouraging barter deals--will enable Sino-Yugoslavian economic contacts to expand in 1987, in our judgment. More than half of the 64 projects scheduled for industrial cooperation in 1987 involve some form of countertrade, according to press accounts. [redacted]

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In contrast, we believe China's economic relations with Romania, Czechoslovakia, and Hungary--already showing strains--will falter:

- According to the Chinese commercial counselor in Bucharest, the **Romanians** want hard-currency payments for what the Chinese consider to be inferior goods, while China has called for 100-percent barter trade.
- The current bilateral trade protocol calls for **Czechoslovak** trade this year to drop to its 1983 level. According to a Chinese diplomat in Prague, the Chinese blame the anticipated fall on the slow Czechoslovak foreign trade bureaucracy and the need for Soviet approval for the sale of Czechoslovak products containing Soviet-origin components.
- We believe that trade with **Hungary** this year will remain at the 1986 level, as called for in the 1987 trade protocol. The trade mix will have to be altered before trade can be greatly increased; China does not desire any more Hungarian trucks and Hungary is not in need of additional Chinese consumer goods.

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Implications for the United States

Despite the attractions of barter, we believe China generally will continue to prefer high-quality US and Western equipment to that available in Eastern Europe. However, when comparable equipment and technology are available from East European suppliers--as in power-generation machinery, railcars, and heavy trucks--China probably will find barter with Eastern Europe preferable to spending hard currency on US goods. China may use its growing barter trade with the Bloc to press the United States for more barter and countertrade to help alleviate its shortage of hard currency.

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China's technology transfer to the Bloc is of potentially great significance but will probably not become a problem. Beijing is aware of US concerns that the Soviet Union might attempt to take advantage of China's greater access to Western technology, and--despite warmer ties to Eastern Europe--we believe shares US convictions that transfers of technology that would contribute to Soviet military strength must be avoided at all costs.² Beijing also recognizes that its access to Western technology would be sharply curtailed if China were found to have violated end-use certificates agreeing not to transfer COCOM-controlled items.

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As a result, we believe Beijing will rebuff overtures to transfer COCOM-controlled items to Eastern Europe. Beijing, in fact, manages all trade with Eastern Europe, and also tightly controls reexports of Western technology to any third countries [redacted]. Nonetheless, we expect such overtures to continue as contacts between Chinese and East European entities--particularly in high-tech areas--proliferate and it becomes more difficult for Beijing to monitor its factories and corporations.

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Activities not covered by COCOM controls are also likely to increase. Although we know little about the specific activities to take place under Sino-East European S&T agreements covering high-tech areas, we believe that exchanges of scientists and technicians will at times involve transfers of the knowledge gained by Chinese engineers and scientists trained in the West or involved in Sino-foreign cooperative ventures.

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[redacted] We believe, moreover, that visits to China by East European technical personnel will bring East Europeans into facilities that have sophisticated Western equipment.

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