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**DIRECTORATE OF INTELLIGENCE**

28 March 1986

**China: The Year in Review**

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**Summary**

Economic considerations dominated China's political agenda in 1985 to an unusual degree. Buoyant after the October 1984 party meeting that endorsed urban economic reforms, Deng Xiaoping and his supporters within the Chinese leadership sought to make 1985 the "Year of Reform," carrying out controversial new economic policies and seeking to improve and consolidate their hold on the levers of power. [redacted]

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But economic policies did not fulfill the reformers' expectations, and they even exacerbated a number of China's existing economic problems. The government was rocked by soaring inflation, an overheated industrial sector, a sharp trade deficit and diminished foreign currency reserves, a 7-percent dropoff in grain production, and a growing corruption problem, all of which gave political critics of reform the opportunity to renew their attacks at mid year. [redacted]

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This memorandum was prepared by [redacted] Office of East Asian Analysis. Information available as of 28 March 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Domestic Policy Branch, China Division, OEA, on [redacted]

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Despite the increased pressure, Deng and his allies were able to bring off a significant political victory at the September Conference of Party Delegates. At that meeting, Deng managed to secure the retirement of numerous members of the party's conservative Old Guard--including 10 members of the Politburo--and replaced them with younger, better educated leaders more committed to the principles of reform. Party conservatives nonetheless remain a formidable force. Party reformers have recovered somewhat from the political difficulties of last year, but the complexity of the economic problems that face China has evidently made them more cautious, and they have set as their goal for 1986 "consolidation and digestion" of reforms already undertaken, and economic stabilization. [REDACTED]

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Economic considerations played a major role in China's foreign relations as well, although strategic concerns remain the central focus. Chinese leaders expressed satisfaction with the "stable" nature of relations with the United States, which permitted a 25-percent increase in bilateral trade (to about \$8 billion). No major trade or political issues emerged in 1985, although the usual problems of Taiwan, textiles and technology transfer remain in dispute. [REDACTED]

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Last year saw a concerted attempt on China's part to test the new Soviet leader's interest in rapprochement: anti-Soviet polemics were reduced, and the level of official contact between the two governments was raised somewhat. Gorbachev did not offer any significant concessions on the fundamental issues dividing the two sides, however, and, by the end of the year, the atmospherics had cooled noticeably, with the Chinese refuting Soviet claims that relations were improving. Economic relations between China and the Soviet Union continued their slow trend of improvement in 1985, with bilateral trade approaching \$2 billion. [REDACTED]

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### **Domestic Politics**

Last year, the first full year in which to measure China's performance under economic reform guidelines and policies, was a trying one for China's reform leadership. Starting off the year full of enthusiasm for the economic reform policies approved at the landmark Third Plenum of the 12th Central Committee (October 1984), party leaders went from ebullient confidence to gnawing doubt and defensiveness to stiff determination as they watched the economic, political, and social effects of their policies. Having based their political philosophy on their ability to bring about economic improvement, party reformers, led by Deng Xiaoping, were bruised by accusations from conservatives last summer that they mishandled economic policies in 1985. Although the problems did not prevent Deng from making important political gains at the Party Delegates conference held in September, they clearly were enough to slow the momentum of political and economic reform. [REDACTED]

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[redacted]

Deng Xiaoping, 82, is still the linchpin of the political system in China, and concerns about the state of his health emerged when Deng stopped making public appearances for a two-month period in late 1985 and early 1986. Deng showed up for Chinese New Year in his home province of Sichuan, but speculation about him and possible succession changes intensified last year. Deng himself evidently helped fuel the rumors at mid year, when, according to Hong Kong publications, he developed a "second stage" succession package. [redacted] at some point in the next two years, the following leadership changes will take place: Deng will resign as Chairman of the party Military Commission, and will be replaced by Hu Yaobang; Hu Yaobang will give up his post as General Secretary of the party to Secretariat Standing Secretary Hu Qili; President Li Xiannian will retire and his job will be taken over by Premier Zhao Ziyang; Zhao will be succeeded as premier by one of his younger Vice Premiers, Li Peng or Tian Jiyun. [redacted]

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Although the changes were not put into effect at the September Conference of Party Delegates--as some had speculated--Deng did bring off a major political realignment at that meeting, a rejuvenation of the party's leadership that is consistent in intent with the "second stage" succession scenario. At the Central Committee plenum that preceded the Delegates Conference, 65 elderly members of the Central Committee resigned, including 10 members of the Politburo and one of six members of the crucial Politburo Standing Committee. The full Delegates Conference then chose 91 new Central Committee members, preparing the way for the "election" at the ensuing Central Committee plenum of six new Politburo members and five additional members of the Secretariat. [redacted]

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Generally speaking, the leadership changes shifted the balance within all the leading party organs in favor of those associated with reform. Almost all of the Politburo retirees were considered "conservative" on reform issues, and seven of them were representatives of China's armed forces, which sometimes has been viewed as being in opposition to Deng's reforms. Most of the new leaders meet Deng's succession criteria of younger, better educated, professionally qualified, and politically reliable (read non leftist). Within the Politburo in particular, the addition of Hu Qili, Tian Jiyun, Wu Xueqian, and Qiao Shi appears to significantly strengthen the reform group within the leadership. New Politburo members Yao Yilin and Li Peng, although they publicly support and administer reform policies, seem to lean toward Politburo Standing Committee member Chen Yun, who emerged last year as reform's principal detractor. [redacted]

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Deng by no means swept away all opposition to his programs at the party meetings. The strongest voices in the conservative cause, in fact, maintained their party positions: Chen Yun and Li Xiannian on the Politburo Standing Committee, Peng Zhen and Hu Qiaomu on the Politburo, and Deng Liqun on the Secretariat. It also appeared that Deng had to compromise on some personnel issues, on the pace of implementation of reform policies, and on the ideological tone of the party's programs. Deng's own speech to the assembled delegates stressed some conservative themes, including the need to improve the knowledge of Marxist theory within the party. Deng also had to sit through a bitter diatribe from Chen Yun, who made his complaints about some aspects of reform completely clear, and implicitly warned Deng not to try to stifle dissent within the party. [redacted]

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In the period leading up to the conference, leadership tensions had been quite high, and we believe this was a factor in the way Beijing handled economic policy during the middle part of the year. China's leaders were confronted with a considerable amount of bad news during the late spring and early summer: high industrial growth rates, a startling increase in the money supply and capital construction expenditures, urban food price inflation, skyrocketing imports and a downward plunge in foreign exchange reserves, a gloomy agricultural forecast, and a host of corruption scandals, many of them involving the Special Economic Zones. Reform critics seized on these and other issues and, in our view, forced the reformers into a defensive position. This accounts for, among other things, Deng's statements in July that the SEZs were "experimental," and could fail. [REDACTED]

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Since the party conference, reformers have continued to be defensive in their speeches and articles about economic policies, but less, we believe, because they fear conservative attacks, and more because the policies themselves have been flawed, or incorrectly implemented. Moreover, reformers such as Tian Jiyun and Wan Li have begun openly to rebut the criticisms leveled at reforms by conservatives last year, particularly on such issues as grain production and rural industry, and the linkage between reform policies and corruption. In sum, we believe the reformers have regained the initiative as a result of the changes brought about by the Party Delegates Conference, but will not use it to push through any controversial new reforms. Instead, they have declared 1986 to be a year of "consolidation and digestion" of reforms already undertaken. [REDACTED]

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### Foreign Policy

China increasingly is tailoring its foreign policy to serve its economic modernization drive. This is reflected in Beijing's efforts over the past year to improve relations with both Washington and Moscow. Relations, however, continue to be closer and smoother with the United States. Indeed, the Chinese continue to regard the United States as an important strategic shield against Soviet military pressure as well as a key source of investment capital and technology. [REDACTED]

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Chinese leaders repeatedly stress that Sino-US relations are "stable"--reflecting their interest in seeing the economic relationship in particular continue to grow. Bilateral trade jumped last year by more than 25 percent, from \$6 billion to about \$8 billion, according to US customs statistics. Direct US investment also increased to just over \$1 billion--most of it in offshore oil exploration and drilling. Economic ties are likely to get a further boost as a result of recent US efforts to streamline COCOM procedures for handling Chinese requests for licenses for Western technology. US exports of advanced technology in fact rose to \$500 million in 1985 and almost certainly will increase again this year. [REDACTED]

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The US-China military relationship is developing at a gradual pace but has hit some snags along the way. The United States has taken some initial steps to assist China with military modernization. A key component of that assistance--the sale of an avionics package for the Chinese F-8 fighter--is now before the US Congress for

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approval. But Chinese demands that Washington give private assurances that visiting US warships would not be carrying nuclear weapons forced the US Navy last spring to postpone indefinitely a planned port call to Shanghai. [REDACTED]

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The differences over the port call appear to reflect an increasing reluctance on the part of some senior Chinese leaders to have China identified strategically with the United States--lest that complicate Chinese efforts to improve relations with Moscow and compromise China's more independent foreign policy posture. Over the past year or so, and especially since the accession of Soviet General Secretary Gorbachev, Beijing has made several symbolic concessions designed in part to test the new Soviet leader's interest in seeking a rapprochement with China. In addition to referring once more to the USSR as "socialist," and Soviet leaders as "comrades," the Chinese have cautiously agreed to reestablish some long-severed ties--trade union and parliamentary relations. They have stopped short of agreeing to restore formal party-to-party ties, presumably hoping to extract a significant Soviet political concession in exchange. [REDACTED]

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Thus far, Moscow has been unwilling to offer such a quid pro quo. At the recent Soviet party congress, Gorbachev reiterated the standard Soviet line of offering to improve relations with China as long as it was not at the expense of any third party--a not very veiled reference to Soviet allies in Vietnam, Afghanistan, and Mongolia. As a result, progress toward an expansion of political relations appears to have stalled once more over China's demands for satisfaction on the so-called "three obstacles"--that is, that the Soviets either withdraw their forces from Afghanistan, cease their support for Vietnam's occupation of Cambodia, or substantially reduce Soviet forces along the Sino-Soviet border, including those in Mongolia. [REDACTED]

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After months of muting their criticism, the Chinese in fact have increased the volume recently of their attacks on Soviet foreign policy. They also have rebuffed Moscow's efforts to pin down dates for the exchange of visits by Soviet and Chinese foreign ministers, which Beijing agreed to in principle last fall. It would appear that the Chinese are trying to exploit the Soviets' interest in the visits to induce Moscow to adopt a somewhat more flexible approach to some of the security issues that divide them. [REDACTED]

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Sino-Soviet economic relations continue to improve. Over the past three years, bilateral trade has increased substantially, approaching \$2 billion. The Chinese and Soviets are moving ahead, for example, with plans for the Soviets to help modernize some factories they built in the 1950s, and to build several new projects. Even if political relations remain stalemated, the Chinese probably calculate that expanding economic ties will help to keep tension with Moscow manageable, and will give them access to some useful Soviet technology. [REDACTED]

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China's relations with Western Europe, Japan, and much of the Third World also are being shaped increasingly by economic considerations--that is, the desire for markets, raw materials, technology, and investment capital. In the case of Western Europe and countries around China's periphery, strategic considerations of course still weigh very heavily. The Chinese continue to strongly support Pakistan and the Afghan resistance as well as Thailand and the Cambodian insurgents as a means of keeping the

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**Soviets and their allies in check. By the same token, they remain supporters of a strong NATO as a counterweight to the USSR. In Northeast Asia, Beijing would like the United States and Japan to make some overtures to North Korea to help China counter the recent increase in Soviet influence in P'yongyang. Chinese leaders continue to urge Washington in particular to agree to hold tripartite talks with North and South Korea as a means of reducing Moscow's ability to exploit tensions on the peninsula.** [REDACTED]

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