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**DIRECTORATE OF INTELLIGENCE**

14 April 1987

**China: The Politics of Grain**

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**SUMMARY**

Conservative leaders are becoming more critical of market-oriented rural reforms that they believe--with some justification--have contributed to a leveling off in grain production, a key barometer of success for the rural reform program. If the current drought persists, damaging this year's grain harvest, this criticism will probably intensify. Indeed, we believe conservatives would try to capitalize on forecasts of a poor harvest to put reformers on the defensive when Chinese leaders meet late this summer to hammer out arrangements for the October party congress. We believe reformers already have sought to accommodate some conservative concerns and are playing down new rural reforms. Nevertheless, a poorer than expected harvest coming on top of other economic problems (decreasing foreign exchange holdings, state budget deficits, and increasing state enterprise losses) would not only damage the reformers' ability to regain the initiative, but hurt their chances of gaining the key personnel changes they want prior to the party congress.

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**1987--A Nervous Eye on Agriculture**

Drought has reportedly affected about 10 percent of China's cultivated acreage, including key grain producing areas of the north China plain and south China. If favorable weather returns soon, China could still have a respectable harvest, but we believe Chinese leaders are concerned that production will fall far short of the target they have publicly set of 405 million metric tons--14 million more than last year and nearly equal to the 1984 record harvest. [REDACTED]

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Leadership concern over the size of the grain harvest has its roots in part in the Maoist period. Following the famine years of 1959-1961, brought on by a combination of bad weather and the disastrous policies of the "Great Leap Forward," grain production became the key measure of agricultural success, embodied in the Maoist dictums of "take grain as the key link" and "store grain everywhere." Conservative leaders still regard good grain harvests as a key to national stability and have long feared that rural reforms would hurt grain production. [REDACTED]

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These concerns, however, are not just rooted in the past. Despite sharp production increases in the early 1980s, China's grain supply remains precarious because of rising demand. A recent study by the US Department of Agriculture suggests that because of China's increasing population and changing food consumption patterns, as well as Beijing's decision to export grain to help finance the modernization program, Beijing has been unable to increase its grain reserves. Indeed, the study concludes that by 1986, demand was approaching the limit of available supplies. Although China has not disclosed the size of its grain stocks, Vice Premier Tian Jiyun recently acknowledged that this year supplies will be tight even if China has a record grain harvest. If the drought persists, we believe that Beijing will have no choice but to draw down grain stocks and use scarce foreign exchange to import more grain to meet both domestic demand and export obligations. [REDACTED]

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### Rural Reforms Draw Increasing Fire

Market-oriented rural reforms introduced in the late 1970s by Deng Xiaoping and his proteges initially boosted agricultural production by giving peasants incentives linked to their performance.<sup>1</sup> These policies produced a string of bumper harvests through 1984 that bolstered the position of reform leaders and provided the impetus for subsequent urban reforms.

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Reform leaders now face a dilemma, however. Since 1984, grain production has leveled off. To reinvigorate production, reformers would like to introduce additional market-oriented reforms--the so-called "second stage" rural reforms--but they cannot afford to free grain prices to stimulate production without either increasing food subsidies, or allowing price increases to be passed on to urban consumers. In our judgment, Beijing regards the first option as too expensive and the second as too risky politically. Given these constraints, the reformers admit they see no alternative but to continue to rely on some quota purchases of grain at low state-set prices.

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The conservatives have jumped on the leveling off of grain production to criticize certain market-oriented rural reforms, which they regard--with some validity--as being responsible for this problem and others that have developed. Conservatives point out, for example, that:

- Loosening price controls on a wide variety of goods and boosting the money supply have led to inflation that in turn increased the cost of producing grain. Since grain prices have not been allowed to rise accordingly, grain production has become less profitable. A report in People's Daily claims that in one key grain producing region, the price of electricity doubled, water charges tripled, and diesel fuel prices quadrupled since reforms were introduced, resulting in a net income decline of 120 yuan per acre of harvested grain. As a result, peasants have turned to producing other, more lucrative cash crops not subject to state price controls. (see graph)

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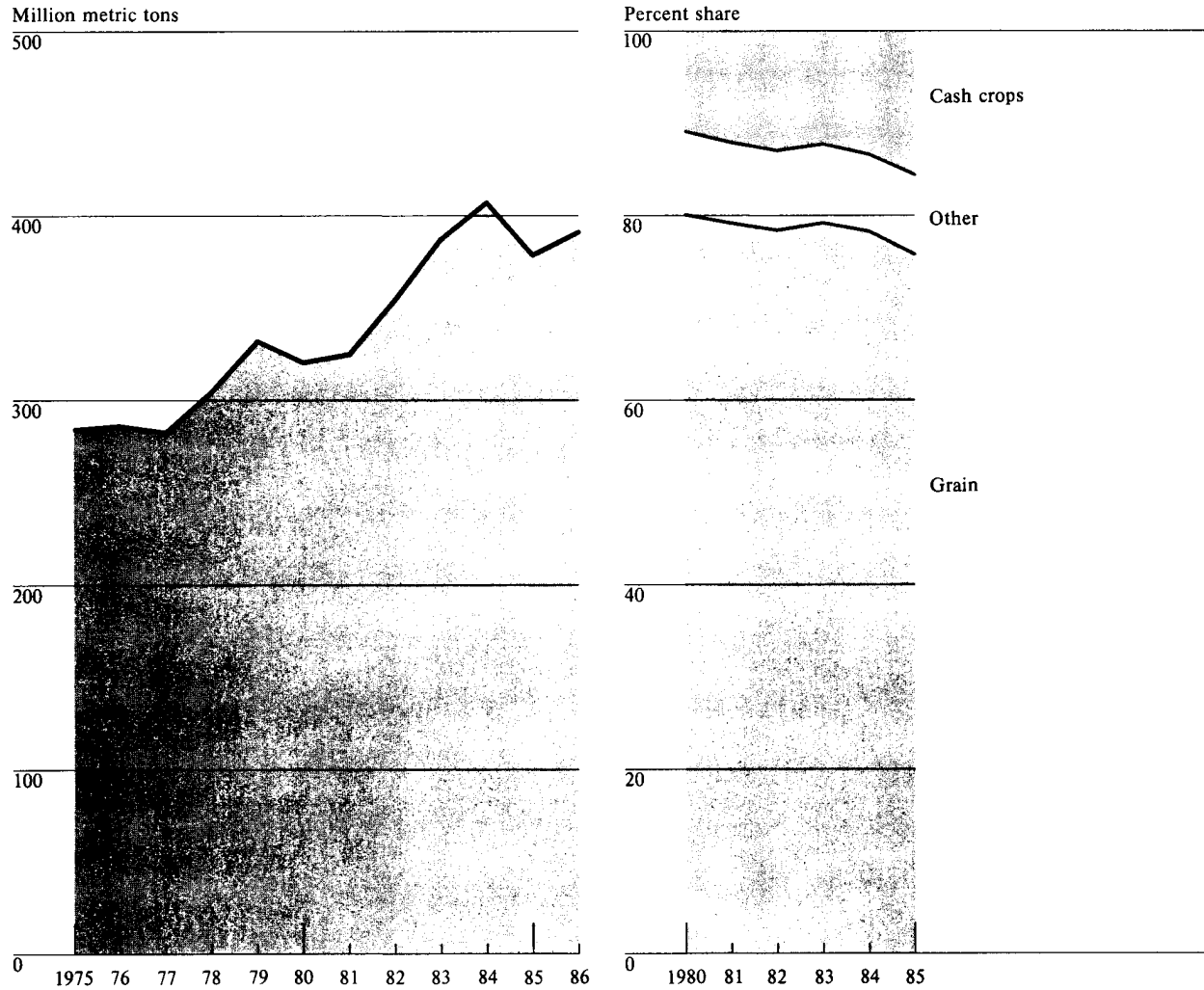
<sup>1</sup> Key elements of reforms initiated in the late 1970s and early 1980s included:

- Raising prices the state paid to farmers for grain, cotton, hogs, and several other key agricultural commodities.
- Transferring decisionmaking authority from rural officials to peasants through the "household responsibility system."
- Expanding rural free market outlets for nonrationed agricultural products, such as vegetables and some meats.
- Encouraging peasants to engage in entrepreneurial activities such as fish and poultry breeding, service trades, and small-scale industrial and mining enterprises.

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### China: Grain Production and Shares of Sown Area



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- Government encouragement of rural enterprises opened other, more profitable opportunities for peasants than growing grain; rural enterprise development also diverted scarce credit and supplies from basic agriculture. (See inset for discussion of rural enterprise development and problems.)
- Policymakers miscalculated in assuming peasants would invest a portion of their increased earnings in maintaining crucial infrastructure, such as irrigation facilities, and thus failed to earmark enough state money for this purpose. As a result, development and maintenance of irrigation facilities have suffered--investment in water conservancy reportedly declined from 2.1 billion yuan in 1980 to 1.1 billion yuan in 1984. Reformers are, therefore, vulnerable to charges that their policies have reduced China's ability to withstand drought.
- Peasants have put much of their increased earnings to "nonproductive" use. For example, a Chinese policy researcher claimed that some 7 billion square meters of rural housing was built from 1980 to 1986, at an estimated cost of 120 billion yuan. Some conservative leaders have attacked this "consumer-oriented" spending for reducing funds and supplies needed to increase production.
- Construction of houses, enterprises, and roads also have cost the nation vital cultivated acreage--between 1980 and 1985 the yearly decline in cultivated land averaged roughly 500,000 hectares. Although this is a yearly loss of less than one-half of 1 percent of China's total cultivated acreage, much of the lost acreage has been among the country's most productive. [redacted]

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Conservatives also charge that rural reforms have exacerbated social problems by encouraging income inequalities, corruption, increases in the practice of traditional forms of religion and superstitions, and a breakdown in some social services such as health care and care for the aged. Moreover, they maintain that the rural party apparatus has suffered under reforms--rural party officials, once in charge of rural development, now have an ill-defined role and are even forbidden from engaging in many of the profitable activities available to the peasantry. [redacted]

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#### **1987 Rural Policy--Caution Prevails**

We believe Zhao Ziyang and other reformers are well aware of the potential political fallout from a poor grain harvest, and indeed share conservative concerns over the economic consequences of such a shortfall. Hoping to blunt conservative criticism, reform leaders apparently have taken the lead since last fall's work conference on agriculture in addressing concerns over declining investment and growing inequalities in rural development:

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### China's Rural Enterprises: Controlling the Boom

The rapid development of rural enterprises is a key issue in the debate over rural policies. Reform policies encouraged peasant entrepreneurship and the development of small village and township-run enterprises in order to diversify agriculture and to soak up excess rural labor. The most dramatic growth of these enterprises, which include animal husbandry, fish and poultry breeding, small-scale industry and mining, and services, occurred in 1985, when employment jumped from 14 to 20 percent of the total rural labor force. In 1986, the output value of these enterprises exceeded that of agricultural production for the first time, according to Chinese statistics. [redacted]

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Conservative leader Chen Yun charged in September 1985 that rural policies had led peasants and rural leaders to believe that there could be "no wealth without industry," forgetting that there is "no stability without agriculture." Even reform leaders have admitted that rural enterprises have many problems, including mismanagement, poor quality products, and the inefficient use of scarce energy and materials. Agriculture Minister He Kang recently told US officials that roughly 10 percent of rural enterprises are going bankrupt every year, and noted that it did not make sense to continue to encourage new enterprises. [redacted]

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We believe reform leaders are now trying to address problems of rural enterprises without damaging progress in rural industrialization. Finding a path between "boom" and "bust" in rural enterprise development has proven difficult, however. Last year Beijing attempted to slow their growth by reducing credit and supplies to the sector, reportedly forcing hundreds of thousands of households and entrepreneurs to abandon their businesses, and increasing the numbers of rural enterprises running deficits. Faced with the prospect of increased rural enterprise failures, rising rural unemployment and large numbers of defaulted loans, Beijing loosened supplies and credit in mid year. [redacted]

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This year Beijing is reportedly encouraging the development of local rural credit institutions, in part to provide more local funds for rural enterprises. We believe Beijing hopes this will reduce the burden, and risk, on the state credit system, as well as increase the likelihood that funds are channeled to enterprises that have good financial prospects. Basic rural enterprise problems remain, however, and conservatives will probably continue to attack the overheated growth of the sector as a sign of reformers' mismanagement of agricultural policy. [redacted]

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- Recent rural policy documents call for a 40-percent increase in state investment in agriculture, with priority given to water conservancy projects in grain producing and less-developed areas.
- Vice Premier Tian Jiyun recently announced plans to increase state aid to underdeveloped areas, including the distribution of some 1 billion yuan in development loans to these areas annually through 1990. [ ]

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We believe reform leaders are continuing to take a more cautious approach to rural policy because of rising concern over the effect of the drought. In his work report to the National People's Congress on 25 March, Zhao placed agriculture first among economic problems needing attention. Although he called for deepening reform, he proposed no specific new reforms. Instead, Zhao emphasized the need for the government to invest more in technology to improve yields and called for a series of new unspecified "guidances"--perhaps referring to administrative measures to protect farmland and ensure grain production. Beijing has also made only incremental adjustments in this year's grain purchase formulas, reducing the state grain purchase target from 60 to 50 million metric tons. Rural policy experts have emphasized that the "double track" grain procurement system will be used for a long time--meaning that some quota grain procurement at low state-set prices will continue to be used to achieve grain procurement targets. [ ]

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Conservatives appear to have gained some ground, meanwhile, in redirecting the party rectification campaign that has been under way in rural areas since 1985. Last December, rectification leader and leading economic conservative Bo Yibo, whose influence has increased since Hu Yaobang's fall, complained that the campaign had placed too much stress on promoting market-oriented reforms, neglecting party work style and education in communist principles. Although Bo stated that the objective of rectification is to support reforms, his speech suggests he will try to shift the campaign from promoting market-oriented reforms to helping rebuild the reputation and authority of the rural party apparatus. [ ]

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### **Impact on Party Congress**

The success of rural policies has been the cornerstone of the reform program. A respectable harvest, therefore, would help reformers deflect conservative criticism. By the same token, a poor harvest, coming on top of other, persisting economic problems (declining foreign exchange reserves, increased state enterprise losses, and rising state budget deficits), would, in our judgment, be a serious blow to the reform camp, and Deng Xiaoping. Indeed, according to official press, delegates to the recent National People's Congress criticized Zhao Ziyang for not paying enough attention to agricultural problems in his work report. A provincial leader also reportedly complained that the government's grain policies are dealing with "trifles rather than essentials." (C NF)

Because the preparatory meetings for next fall's 13th party congress will probably coincide with preliminary grain forecasts, we believe conservative leaders would

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capitalize on projections of a grain shortfall to try to dominate these meetings. The reformers, therefore, could find themselves on the defensive on a key policy matter and in a weakened position to press for the personnel changes they want, including the choice of Zhao's successor as premier. Conservatives, such as Bo Yibo, operating under Deng's overall direction, apparently already have been charged with drawing up recommendations for changes in the composition of the party's central committee--a move we believe Deng made to mollify conservative complaints that Hu Yaobang had monopolized party patronage at their expense. In our view, the conservatives might also use their increased say in personnel matters to try to veto Zhao's preferred candidate for the premiership, Vice Premier Tian Jiyun. Tian, who has worked closely with Zhao since the late 1970s in implementing rural policies and is now in charge of the implementation of the overall reform program, would, in our judgment, be very vulnerable to conservative attack if the grain outlook was bad. Although far less likely, even Zhao's confirmation as party chief at the congress could run into trouble if economic problems worsen. [redacted]

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We believe a poor agricultural outlook would also make it harder for the reformers to control the agenda of the congress. Rather than gaining an endorsement to move ahead with reform, they could find themselves trying to fend off conservative efforts to roll back and circumscribe some reform policies and to reimpose greater centralized planning and control in general. [redacted]

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