

IR 80/86 - CHINA:  
Marching Down the Road of  
Economic Reform.

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CHINA: Marching down the Road of Economic Reform

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CHINE: Sur la voie de la réforme économique

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- 1 -

CHINE: Sur la voie de la réforme économique

Résumé

1. Le remarquable succès des récentes politiques économiques permettra aux autorités chinoises de procéder à d'autres réformes économiques durant le prochain plan quinquennal. Mais il leur faudra s'attaquer à un certain nombre de problèmes qui ont accompagné les réformes économiques pour faire taire les critiques conservatrices et prévenir l'instabilité économique. Les périodes de décentralisation devraient continuer à alterner avec les périodes de resserrement des contrôles de l'État, les Chinois mettant à l'essai d'autres réformes économiques. La disparition de Deng Xiaoping, ou, dans une moindre mesure, son départ prochain pourrait constituer une source d'instabilité politique et économique à court terme. Mais l'avancement considérable des réformes économiques et les appuis politiques importants qu'il s'est ménagés au fil des ans devraient aider à assurer la continuité du programme de réformes du moins pour le reste de la décennie et probablement après. On ne renoncera, toutefois, pas aux principes socialistes. Le Canada devrait continuer à jouir d'un large excédent dans ses échanges commerciaux avec la Chine à moyen terme, vu les besoins considérables de celle-ci en importations, quoique les nouvelles restrictions imposées aux importations pourraient entraîner une baisse des exportations canadiennes à court terme. Les perspectives d'accroissement des ventes céréalières à la Chine restent sombres dans le proche avenir étant donné la stagnation de la demande de blé. (CONFIDENTIEL)

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- 1 -

CHINA: Marching Down the Road of Economic Reform

Summary

1. The remarkable success of recent economic policies will enable the Chinese authorities to press ahead with further economic reforms during the next five year plan. But a number of problems that have accompanied economic reforms will have to be addressed in order to placate conservative critics and to prevent economic instability. Periods of decentralization are expected to continue to alternate with those of tighter state control as the Chinese experiment with further economic reforms. Deng Xiaoping's death or, to a lesser extent, his retirement in the near future could lead to some short term economic and political instability. But the considerable progress of economic reforms and substantial political support that he has built up over the years should help to ensure the continuity of the reform program at least for the remainder of the decade and likely beyond. However, socialist principles will not be discarded. Canada should continue to enjoy a substantial surplus on trade with China in the medium term, given China's considerable import requirements, although further import restraints could reduce some Canadian exports in the short term. Prospects for increased wheat sales to China remain poor in the near future, because of the stagnant demand for wheat imports.

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.../2

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- 2 -

Report

2. China has achieved enviable growth rates since economic reforms were initiated in the late 1970's. Rural reforms have been largely responsible for the significant growth in agricultural output over the last five years averaging some 13 percent annually. This compares with an average growth of just under five percent in the previous five years. China has switched from its position as substantial grain and cotton importer to one of a net exporter of these products in 1985. Improved economic incentives and greater enterprise autonomy contributed to an increase in total output of goods and services averaging 10 percent annually over the same period, surpassing growth rates of all other developing countries in the region. China's shift from its earlier isolationist foreign policy to an "open door" policy has been responsible for an increase in total trade of close to 40 percent over the last five years.  
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3. Comprehensive political changes have accompanied economic reforms. Most notably, at the September 1985 Party Conference, Deng Xiaoping and his protégés were successful in replacing many of the older, more conservative elements within the party, with younger reform oriented technocrats. Considerable political support within the Party helped Deng's strongly reformist current five year plan proposal to pass at that Conference. Nonetheless, public criticism by several conservative opponents showed that there was still serious opposition to Deng's policy in some quarters. Deng was forced to make concessions to his opponents by supporting a greater role for socialist principles in carrying out economic reforms.  
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4. Despite considerable support for reformist policies, there is widespread concern over a number of problems that have accompanied economic reforms. Overall prices officially increased by 8.8 percent in 1985, the highest since the 1950's, while some urban centres reportedly experienced double digit inflation. A substantial increase in imports in late 1984 and 1985 led to a record trade deficit last year and a sharp drop in foreign exchange reserves. Deficit problems were partly responsible

.../3

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- 3 -

for the Chinese authorities decision to slow growth in special economic zones. Rapid industrial growth put considerable strain on the country's infrastructure. Reduced state control resulted in a rising incidence of crime and corruption. Expanded rural reforms in 1985 caused a shift in the composition of agricultural output and were partly responsible for the first drop in grain production in seven years. While the fall in grain output did not have serious economic consequences because of China's substantial grain stockpile, the negative political repercussions were more serious.

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#### Outlook

5. The Chinese are planning to address these problems in the medium term, while continuing to press ahead with economic reforms. But 1986 is planned as a year of consolidation and retrenchment. The recently approved five year plan stresses the need for more moderate and balanced growth. Gross national product is targetted to grow by an average 7.5 percent over the next five years. While the authorities admit to the need for a more rational price system, they plan to progress slowly in this politically volatile area, and no major price increases are planned for 1986. Improved economic incentives are being given to increase grain output. Import controls are being tightened and greater efforts are being made to diversify exports in order to conserve foreign exchange reserves. The Chinese are experiencing difficulties in reducing the trade deficit, because of continuing strong import demand and a sharp drop in oil export revenues. This poses no immediate threat since foreign exchange reserves are officially some US \$10.6 billion, invisibles earnings are increasing, and the Chinese can further increase commercial borrowing given their low debt service ratio and excellent credit rating. Nonetheless, poor medium term prospects for diversifying and expanding exports could make foreign exchange constraints an increasingly serious problem over the rest of the decade.

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6. While the Chinese are expected to achieve their relatively moderate five year economic growth targets, considerable fluctuations in year-to-year growth rates are possible. The authorities' inexperience in using monetary

.../4

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- 4 -

and fiscal controls will make it difficult for China to consistently achieve moderate growth levels. The complexity of urban reforms is likely to prevent the Chinese in the near term from achieving the rapid success that has accompanied rural reforms. As the Chinese experiment with further economic reforms, periods of decentralization are expected to continue to alternate with those of tighter state control. The Chinese will continue to grapple with the problem of incorporating free market principles into a socialist system. A dual economic system is expected to remain, with a state planning and distribution system co-existing with a number of quasi-free marketing systems based on more flexible prices. (CONFIDENTIAL)

7. The future progress of economic reforms depends on Deng's succession. Eighty-one year old Deng's health appears to be good. He continues to play a key role in formulating economic policies and in mediating factional disputes, despite his claims that he has disengaged himself from day-to-day affairs. While Party Secretary Hu Yaobang and to a lesser extent Prime Minister Zhao Ziyang are currently Deng's designated successors, neither is considered to have Deng's prestige and power within the Party and the government. Although several capable "third echelon" officials have recently been promoted to senior positions, these officials are not in the position to take power in the near future. Deng claims that he will retire at the Party Congress in 1987. If he does step down, he will continue to exert considerable influence from the "wings". Deng's death or, to a lesser extent, his retirement could lead to some economic and political instability in the short term. The political support that he has built up over the last several years and the considerable progress made in expanding economic reforms should help to ensure the continuity of his reform program at least for the remainder of the decade and likely beyond. However, much will depend on the success of urban reforms. Changes will continue to be made within the socialist framework and opposition to reform policies will not be eradicated. (CONFIDENTIAL)

.../5

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- 5 -

Canadian Implications

8. Canada should continue to enjoy a large positive balance on trade with China, given China's considerable import requirements. Canada's surplus on bilateral trade with China was close to C \$856 million in 1985. Since China's next five year plan is to concentrate 70 percent of major project investment on energy, raw materials, transport and telecommunications, the best opportunities for Canadian exporters should be in these sectors. But prospects to increase wheat sales to China remain poor in the near future, because of the stagnant demand for wheat imports. The demand for Canadian products over the medium term will continue to be affected by fluctuations in China's internal and foreign economic policies. In 1986, lower foreign exchange reserves and continuing trade deficit problems could force the Chinese to implement further import controls. While Canada has recently had considerable success in increasing manufactured exports to China, Chinese imports of these products could be constrained over the next several years if their current deficit situation does not improve.

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