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MINISTÈRE DE LA DÉFENSE NATIONALE

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CHINA: Economic and Financial
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Congress by Senior Officials.

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IAC Special Assessment 18/81
Approved: 16 December 1981

CHINA: Economic and Financial Reports to National People's
Congress by Senior Officials

Summary and Conclusions

1. In their opening reports to the National People's Congress, Premier Zhao Ziyang and Finance Minister Wang Bingqian claimed some success in dealing with the country's economic and financial problems, were frank regarding the limited prospects facing the economy for the future and gave no indication that any major shifts in economic policy are planned. Zhao noted that positive growth is expected for 1981 as the result of the recovery of grain production, the growth of non-grain commodities, and high priority for expansion in output of the consumers goods industry. He indicated that housing conditions had improved, employment had risen, peasant incomes were up and that foreign trade would rise this year. Wang reported that government budgetary accounts would likely show a deficit of \$1.8 billion compared with \$8.5 billion in 1980, following major cuts in budget outlays for new construction, defence and aid to farmers. Wang's remarks on the 1982 budget pointed up the funding problems of his ministry and of government spending as a whole. He indicated that he would have to expand price subsidies and other programs, that he had little additional ability to reduce spending in other programs following this year's major cuts and that he expected budget revenues to grow by only 3.9 per cent - reflecting the expected net rate of growth in total output. Zhao noted that the Sixth Five Year Plan (1981-1985) had not been completed and underlined the need for more far-reaching reforms of the system than had been foreseen when current readjustment policies were introduced in 1979. It was indicated that present policies would have to be continued for five or more years and that the immediate tasks were to consolidate the results of present readjustment policies and to balance the country's budget. Zhao's comments on future courses of action reflect official awareness of the country's restricted capital resources, structural imbalances (and therefore limited economic capabilities) and consequent likely slow growth over the next two decades.

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Rapport d'évaluation spéciale du CCR 18/81
Date d'approbation: le 16 décembre 1981

CHINE: Rapports économiques et financiers présentés au Congrès
populaire national par de hautes instances

Résumé et conclusions

1. Dans leurs rapports d'ouverture au Congrès populaire national, le Premier ministre Zhao Ziyang et le ministre des Finances Wang Bingqian ont dit avoir obtenu un certain succès dans leur lutte contre les problèmes économiques et financiers du pays, ont fait preuve de franchise au sujet des perspectives limitées auxquelles fait face l'économie et n'ont donné aucun indice que des réformes importantes de la politique économique sont envisagées. Zhao a souligné qu'une croissance positive est prévue pour 1981 à la suite du redressement de la production céréalière, de l'augmentation des autres productions et de la priorité élevée donnée à l'expansion de l'industrie des biens de consommation. D'après ses indications, la situation du logement s'est améliorée, le nombre d'emplois a augmenté, les revenus des paysans sont à la hausse et le commerce avec l'étranger s'intensifierait cette année. Wang a fait savoir que les comptes budgétaires du gouvernement accuseront probablement un déficit de l'ordre de 1,8 milliards de dollars, comparativement à 8,5 milliards de dollars en 1980, à la suite d'une réduction importante des crédits prévus au titre de la construction, de la défense et de l'aide à l'agriculture. Dans ses remarques sur le budget de 1982, Wang a attiré l'attention sur les problèmes de financement de son ministère et les dépenses gouvernementales en général. Il a laissé savoir qu'il devra accroître les subventions sur les prix et élargir d'autres programmes, qu'il lui est à peu près impossible de comprimer encore plus les dépenses engagées au titre de certains programmes à la suite des importantes coupures de cette année et

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Introduction

2. Both China's Premier and Finance Minister touched on a broad range of economic and financial matters in their opening statements to the current session of the National People's Congress, the body constitutionally responsible for examining and approving national economic plans, the state budget and final state accounts. The economic performance of agriculture and industry in the current year was outlined; general comment and a few details on prices, income, employment, housing, foreign trade and the state budget were presented, as well as a brief summary of future economic and financial policy. (UNCLASSIFIED)

Discussion

3. Premier Zhao Ziyang indicated that stable growth and development in China depend upon the steady expansion of agricultural production, and said that the agricultural situation is good this year in spite of the damage done by serious floods and droughts. He noted that grain output is expected to come close to the 1979 level (a record), cotton output is greater than the record 1980 figure, and that oil-bearing crops are up 17 per cent over last year. Zhao also noted that the production of goods from the private "sideline" activities of farmers has grown quickly. It was left for Finance Minister Wang Bingqian to summarize the aggregate effect of these and other factors by observing that the gross output value of agriculture this year was expected to be up four per cent. (UNCLASSIFIED)

4. According to Zhao, the output of the textile and other light industries will likely rise by 12 per cent while that for heavy industry will decline about five per cent. Though he did not say so, this means that the gross value of

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que les recettes budgétaires ne devraient augmenter que de 3,9 p. 100 - ce qui reflète les prévisions établies en ce qui concerne le taux de croissance net de la production totale. Zhao a révélé que le sixième plan quinquennal (1981-1985) est inachevé et a souligné la nécessité d'implanter des réformes d'une portée plus grande que celles qui avaient été envisagées au moment de l'instauration de l'actuelle politique de rajustement en 1979. On a fait savoir que les politiques actuelles devraient être suivies au moins cinq ans encore et que les tâches les plus pressantes consistaient à consolider l'acquis des programmes courants de rajustement et d'équilibrer le budget national. Les remarques de Zhao sur la future ligne de conduite traduisent la prise de conscience par les autorités des ressources pécuniaires restreintes, des déséquilibres structuraux (et des perspectives économiques limitées par le fait même) et, partant, d'une croissance probablement lente du pays au cours des deux prochaines décennies.

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output of industry as a whole will rise by three per cent.

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5. On prices, Wang alluded to the likelihood that the rise in the money supply this year will be lower than in 1980. He observed that most of the additional money issued this year had been used to support expanded production of goods and to improve commodity circulation, and was therefore normal issuance. Since little change had occurred in the price of basic consumer goods, the Minister added that this year's price index rise would be smaller than last year's. That some inflationary pressures continue was implicit in the Minister's admission that a further budget deficit had occurred.

(UNCLASSIFIED)

6. Comments by both officials on wages point to a higher bill for statutory wages as the result of higher employment and upward reclassification of some teaching and medical staffs. The income of farmers will rise as a product of increased output of field crops and other farm goods. Zhao noted that urban and rural savings rose this year by nearly 25 per cent, and that completions of new residential housing for state workers had been large.

(UNCLASSIFIED)

7. Zhao noted that the total volume of imports and exports would show a large increase this year compared with 1980. He indirectly referred to China's currently large grain imports and hinted that these were likely to continue for some time. He observed that China would continue to expand its foreign trade and would continue to tap foreign sources for advanced technology and funds, and develop various kinds of economic and technical cooperation based on mutual benefit.

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8. On the basis of Wang's domestic currency estimates, the 1981 state budget deficit will probably amount to \$1.8 billion (all dollars are Canadian) on expenditures of \$72 billion and revenues of \$70 billion. He indicated that the deficit in 1980 was about \$8.5 billion and in 1979 over \$11.0 billion. While the Premier made it clear that the reduction in the deficit this year had only been achieved as the result of slashing expenditures, the Finance Minister pointed out that state revenue could not increase rapidly as long as the economy was subject to the present policy of readjustment. Defence expenditures for 1981, as reported by Wang, suggest that publicly acknowledged defence appropriations were reduced by 16 per cent or the equivalent of \$2.2 billion compared with his original 1981 estimates of \$13.4 billion. The Minister also indicated that capital construction outlays were slashed but gave no estimate of likely final outlays for the year. Higher than expected outlays to cover additional pay and other expenses for demobilized military personnel and other security purposes raised total administrative expenditures by about \$800 million. Budget funding for culture, education, health and science apparently declined, however, by nearly \$2.4 billion. (UNCLASSIFIED)

9. The Finance Minister said that the revenues and expenditures in the 1982 budget would rise by four per cent and involve a further deficit. He noted that higher revenues next year would reflect increased output of commodities from the farm and industrial sectors but indicated that further increases in price subsidies, welfare outlays, science expenditures and additional outlays for energy and transport would make it difficult to limit all outlays to expected revenue levels. (UNCLASSIFIED)

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10. Dealing with future domestic economic policy, Premier Zhao acknowledged that the requirement for structural changes in the economy, which had been raised in June 1979 and had produced the present readjustment program, had not been adequately understood. He admitted that it was now clear that the content of the readjustment process was much more extensive than originally envisioned. As a result, it has been decided by senior officials that readjustment will have to be continued for five more years or even longer. Zhao observed that the preliminary outline of the Sixth Five-Year Plan covering 1981-1985 had not yet been completed; that agriculture could not expect to receive much additional investment and that the economic growth rate would not be rapid during this period.

(UNCLASSIFIED)

Comment

11. Grain production this year will evidently be close to 332 million metric tons (mmt) in spite of a decline in grain acreage attendant on changes in crop structure in recent years. (See Special Assessment 15/81 of 16 November 1981: "CHINA: 1981 Agricultural and Food Situation and Implications for Economic Development"). Total gross agricultural output is up by four per cent this year, a rate of increase equal to that of grain production. Since the weight of non-grain commodities in China's composite structure of agricultural goods is large, the rise in total output points to a good rate of growth in the output of industrial crops, fruit, vegetables and animals. Zhao's reference to good cotton and oil-bearing crops and to a good rate of growth in products from private plots (vegetables, animals, honey, silk, etc.) supports this point.

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12. High priority for new investment in and provision of working capital for textile and light (durable consumer goods) industries are key factors in the good rate of growth expected for this sector. The current priorities for consumer goods industries are in keeping with the government's present policy of economic readjustment which is aimed at the rapid expansion in the capacity and output of consumer goods enterprises. Although the government maintains that present industrial policy is aimed at "readjustment" relationships between light and heavy industry, its practical objective concerning the capacity and output of heavy industry has been retrenchment. A considerable quantity of China's heavy industrial output consists of out-of-date producer goods based in many cases on obsolete Soviet designs. The shut-down of facilities and production lines turning out unmarketable products during the first three quarters of 1981 appears to be the reason for the decline in output of producers goods referred to by Zhao. A turn-around in heavy industrial output during the fourth quarter, claimed by Zhao, could point to a flow of new products from recently commissioned modern, or modernized manufacturing facilities. It might indicate, however, that the government restored output in some of the facilities closed down earlier in the year in order to maintain supplies of some marginally acceptable producer goods, to support tax revenues and to reduce unemployment in large urban centres. (CONFIDENTIAL)

13. Inasmuch as Zhao has claimed that agriculture and industry will both expand production this year, it is valid for the Finance Minister to claim that some increase in the money supply was required in order to finance the growth of commodity production. Since we have no evidence that price increases have been either sharp or general in China this

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year (the Chinese acknowledged a 14 per cent rise in retail food prices in 1980), it would appear that inflationary pressures are less troublesome than in 1980. The significant reduction in the budget deficit reported by Wang tends to support this position. (CONFIDENTIAL)

14. Increased wages, income and employment in China in 1981 reflect higher levels of industrial and farm production, the reformation of important pieces of the country's service sector, and the pressures of expediency with regard to employment policy. Higher production in textile and light industries and even some individual producer goods plants will generate bigger pay packets for some workers because of new piece rate and bonus systems. Farmers will earn larger incomes because they have more to sell at roughly constant prices. Even with this year's increases, however, the average monthly wage of a city worker will remain below \$50 and that of an average collective farmer \$10-12. (CONFIDENTIAL)

15. The upgrading of the wage levels of some elementary and secondary school teaching staffs points to the priority that the government is now placing on improving basic elements of the country's educational system. China's pre-university school system was badly affected by the attacks on it during the period 1966-1975. The self-esteem of many teachers was damaged, and the quality of the system depressed and neglected. Higher salaries for teachers are part of the government's attempt to restore the vitality and quality of elementary and secondary education throughout the country and to improve the calibre of students proceeding to vocational and university-level institutions. In view of the current impoverishment of the country's treasury, however, it is unlikely that the government will be able to

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offer increases that show much more than good intent.

(CONFIDENTIAL)

16. The government could save a large portion of its current wage bill if it could shed even a small fraction of those people now working in overmanned party and state organizations and departments. Zhao noted in his remarks to the NPC that there was currently an "intolerable" level of overstaffing and low efficiency in China's bureaucracies and hinted at new measures to deal with the problem. Whatever the government may do, it is almost certain to stop short of simply firing people in order to avoid worsening an already serious unemployment problem. The total number of Chinese workers in all state production and administrative enterprises and organizations in 1980 was 80 million. If, for example, between five and ten per cent of this number were released, it would add four to eight million people to the number of currently unemployed which is variously estimated at between 10 and 20 million in urban centres.

(CONFIDENTIAL)

17. Higher personal savings this year may point, among other reasons, to the continuing reluctance of some Chinese consumers to spend income on the frequently low-quality goods available in their localities or in some instances to find much that was purchasable. Distribution of consumer goods remains a problem in China as a result of poor transportation and storage facilities. Heavy flooding in inland areas this year as well as other abnormalities interfered with normal road and rail traffic and probably interrupted usual distribution of retail goods in many parts of the country.

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18. If the floor space of new state residential housing

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completed this year reaches 80 million square metres as officially estimated, this would be about equal to the amount completed in 1980, the previous record year, and would represent nearly 10 per cent of all the housing constructed since the formation of the PRC in 1949. Although some new housing was built in the period 1949-1964, little was built in the following 13 years. The space added this year should provide approximately 1.6 million housing units sufficient to accommodate 7.2 million people.

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19. Chinese sources reported in July that the total value of imports and exports for the first half of 1981 amounted to the equivalent of \$20.2 billion, up 18.8 per cent compared with 1980. Imports were worth \$10.4 billion, up 22.7 per cent, while exports were worth \$9.8 billion, up 14.9 per cent. The most recent Chinese estimate is that the rate of growth in total 1981 trade will be 10 per cent, pointing to a marked fall-off in trade flows which appears to have affected China's imports in particular. We expect that China's grain imports this year will be roughly the same size as last year or some 14 million metric tons. Although these imports represent only four per cent of China's grain production, they nevertheless provide approximately 50 per cent of the wheat used in all urban areas. China has been slow to borrow much of the credit which its trade partners have made available. High interest rates are part of the answer. The other part appears to be related to the caution instilled in Chinese officials by their multi-billion dollar import program of 1978. This program ended in a series of mini-disasters when officials found that they could not finance a program which the economy could not in any event accommodate for technical reasons. While China has had some success in arranging

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economic and technical co-operation agreements with Western organizations, the continuing lack of clarity in Chinese law and the regulations governing it remains a barrier to rapid progress.

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20. When the details of the 1981 budget were first summarized publicly in the third quarter of 1980, revenues, including foreign loans, were estimated at the equivalent of nearly \$77 billion and expenditures at \$80 billion leaving a deficit of \$3.3 billion. By the first quarter of 1981, Chinese financial authorities realized that declining production in several divisions of heavy industry, a foreign trade deficit and increased subsidies for grain would simultaneously lower government tax revenues and raise government budgetary outlays. To deal with this situation, expenditures were slashed by \$10.5 billion primarily by reducing estimated state investment outlays by nearly \$7 billion, actual defence expenditures by \$2.2 billion and aid to agriculture by \$1.0 billion. Although no provision was apparently made for a deficit in early 1981, a \$1.8 billion figure has been acknowledged, which is just over one-half the deficit expected in the original budget estimate. The deficit reflects among other things higher than expected outlays for demobilized servicemen, as noted by Wang, and possibly a subsidy to cover internal state enterprise losses on foreign trade which is higher than was even expected in first-quarter 1981. It is possible that the hardening of protectionist attitudes and consumer frugality in some of China's export markets has progressed further than Chinese officials may have anticipated in early 1981 and effected their trade.

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21. The Finance Minister admitted that state revenues from enterprises were only 92.7 per cent of those

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estimated. This points to lower than expected operating surpluses in industry as a whole and reflects among other things a decline in production of obsolete producers goods as well as some deflation of oil and coal output data. References to a foreign trade deficit probably related in part to the cost of covering trade losses on goods whose foreign currency selling prices were less than Chinese internal prices converted at nominal exchange rates. Increased subsidies for grain may have been necessary to cover larger purchases by the state at "non-quota" prices. While most grain sales by farmers to the state must be on the basis of low fixed-quota procurement prices, a substantial quantity of grain is now sold to the state at higher prices. (CONFIDENTIAL)

22. The reported decline of \$2.4 billion in expenditures for culture, education, health and science is puzzling. It suggests curtailment of new construction and building for such purposes or a cutback in current operating costs or both. Neither of these developments seems to be in keeping with present policies aimed at improving the quality of state-provided services. It may indicate a major cut in the science vote as a counterpart to the reduction in the defence vote. Science appropriations are believed to cover some military items. (CONFIDENTIAL)

23. Zhao's comments on China's likely future courses of economic action are premised on the knowledge that the economic capabilities of the country are limited both because of restricted capital resources and structural imbalances, and that growth for much of the 1980's and the 1990's will be gradual. The programs implemented to date and aimed at restructuring heavy industry have apparently revealed many more serious deficiencies than the leadership

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realized existed. They have also pointed to a scale of requirements for necessary improvements that goes beyond China's immediate technical, social and financial abilities. One of the most important problems facing heavy industry is the need to consolidate production of engineering goods in a smaller number of plants close to major markets. Many antiquated engineering products now come from a large number of small plants located across the breadth of the country. Immediate consolidation and relocation of the industry would mean widespread plant closures, the release of thousands of workers and huge outlays for the construction of new physical plant. China cannot afford to undertake quickly these measures at a time when it must also attempt to modernize the consumer goods industry, invest in new transport and communication facilities and improve social services.

(CONFIDENTIAL)

24. It has been slowly grasped by senior officials that the readjustment process involves an enormous scale of new investment that covers every sector of the economy. The rational course of action is to undertake a broad range of new investment activities in the widest possible number of enterprises in all sectors. Each new investment activity will have to be relatively small and properly integrated so as to avoid any worsening of the present poor state of technical and economic complementarity throughout industry, agriculture, transport and the energy sector. The returns from this process should be dependable, but they are likely to be gradual.

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25. It is not clear what is delaying the introduction of the Sixth Five-Year Plan covering 1981-1985. Planning bodies in China lack the numbers of engineers, economists

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and accountants needed to make professional feasibility studies, do cost-benefit analyses, draft blue prints and coordinate all these activities in a competent fashion. Even if the Five-Year Plan appears in 1982, it is likely to be more important as a political statement than as an economic and technical document. The Ten-Year Plan for 1976-1985 was discredited and scrapped when it became a liability. It was never a properly designed technical-economic document. (CONFIDENTIAL)

26. Zhao's observation that it will not be possible to invest much in agriculture and that expansion of farm production will depend on "policies and science" is symptomatic of the leadership's realization that even key sectors of the economy will receive only limited additional state assistance in the future. The remark probably rules out any further grand gestures like that of 1979 when state procurement prices for farm products were raised. Farmers, in other words, are being told that they should not expect increased incomes to come from any further shift of income from the cities to the farms which in effect is what the rise in procurement prices accomplished. Wang's remarks on the 1982 budget deficit of \$2.0 billion point up the funding problems of his ministry and the limitation on government spending as a whole. He indicated that he would have to expand price subsidy and other programs, that he had little additional ability to reduce spending in other programs following this year's major cuts and that he expected budget revenues to grow by only 3.9 per cent - reflecting the expected net rate of growth in total output as indicated by the forecast rate of growth in national income.

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27. In effect, Zhao and Wang indicated that they do not

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anticipate any major shifts in economic policy and that the immediate economic tasks are to consolidate the results of present readjustment policies and to come as close as possible to balancing the state budget.

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