

## China's Defense Industrial Modernization and Arms Sales

~~(C)~~ China has a huge military industrial base, second only to the Soviet Union in capacity. The largest sector, ordnance production, has about 200 primary plants. There are 17 major shipyards and 27 key aerospace plants. Additionally, hundreds of other plants controlled by the defense industrial ministries constitute a component supplier infrastructure. As a result, China is self-sufficient in the production of a virtually complete range of basic weaponry. Despite this impressive industrial base, the country generally lacks the capability to produce the most sophisticated military hardware.

(U) In 1978, out of a background of inefficiency, overcapacity, idle plants and workers, technological inferiority, and poor management, the leadership decided to reform the defense industry as a key part of a broad national modernization program. Beijing wishes to:

- o (U) Streamline the weapons development process;
- o (U) Accelerate the acquisition and absorption of domestic and foreign technology;
- o (U) Reduce weapon development time;
- o (U) Promote foreign sales;
- o (U) Integrate defense and civilian industries.

~~(C)~~ To help fund modernization and to preclude heavy procurement of outdated weapons, the state is holding defense spending at a level necessary to maintain only the most essential aspects of deterrence. The modernization program is therefore necessarily selective and gradual.

- o (U) While the announced defense budget, in current prices, has shown modest growth since 1981, defense

spending as a percent of the total budget has exhibited a declining trend for many years. Under China's Seventh Five-Year Plan (1986-1990), annual defense spending is programmed to remain constant and to continue to fall as a share of the state budget. Although the funding of defense ministries and their subordinate industries is separate from the defense budget itself, their resources are also tightly constrained in the overall national budget.

- o ~~(C/NF)~~ Beijing wants to end the large subsidies to arms factories, which often support waste. Mechanisms are gradually being introduced to allow for enterprises to assume sole responsibility for its profits and losses.
- o (U) Part of China's broad economic strategy involves diversion of under-utilized industrial resources from military to civilian production. Closer integration of military and civilian production assets involves selective transfer of military technology to civilian use, the diversion of the defense industry's product base to include more non-military goods, and the outright transfer of defense factories to civilian use.

~~(C)~~ Beijing has devoted considerable effort in the past decade to identifying and obtaining technologies it needs for modernization. With few exceptions, China's needs span the entire spectrum of Western technology. Current economic policies and better relations with Western nations have improved both access to, and utilization of, advanced technology. Despite this emphasis, a number of factors exist which may hinder its efforts to obtain and absorb new technology.

- o ~~(C)~~ Cost is the greatest barrier.
- o ~~(C)~~ Restricted access to advanced technology has been a barrier in the past, but restrictions have faded in recent years under revised COCOM regulations defining China as "friendly but not allied."
- o ~~(C)~~ China suffers from barriers inherent in its own economic system. The largest of these is the poor dissemination within the country of technology already acquired.

- o ~~(C)~~ Another major problem in Chinese industry is the transition from the laboratory to the factory. Although many research facilities are only a few years behind their counterparts in the West, Chinese factories are often unable to apply the available technology in mass production.

~~(S/NF)~~ Foreign assistance is essential for China's defense industrial modernization. The transfer of foreign technology, production machinery, and associated management techniques forms the basis for defense plant upgrades and improved production capabilities.

- o ~~(C)~~ China over the last 10 years has acquired an estimated \$13 billion worth of foreign equipment and technical assistance, including that from the United States, through outright purchases, joint ventures, and illegal acquisitions.
- o ~~(C)~~ While preferring U.S. and Japanese technology, Beijing has avoided becoming overly dependent on any one source. Several nations hold a significant share of China's military and dual-use, high technology market.
- o ~~(C/NF)~~ The Soviet Union and Eastern Europe are emerging as potential suppliers of less sophisticated dual-use technology. Most of the joint projects currently under consideration involve renovation of Chinese plants built with Soviet technical assistance in the 1950s.

~~(C)~~ China aggressively pursues the sale of its military hardware in the international market. This effort helps fund its own arms R&D programs, foreign technology acquisition, and new weapons start-up costs. Major military hardware sold by China includes bomber and fighter aircraft, main battle tanks, surface-to-surface and anti-ship missiles, field artillery, and submarines and surface naval craft.

- o ~~(S/NF/WH)~~ During the 1980s, the country significantly expanded its military sales efforts, selling \$9 billion worth of weapons and associated equipment to 36 countries, primarily in the Middle East and Asia. The Iran-Iraq war has been a boon to China's arms industry. China has sold \$5.5 billion worth of a diverse spectrum of hardware to both belligerents.

- o (U) China recently sold naval frigates and ground weapons to Thailand and surface-to-surface missiles to Saudi Arabia, traditional Western arms domains. Although the Thai sale was at "friendship" prices, and both sales to a large degree may have been intended as political messages to certain audiences, they also may signal a significant turn in China's ability to establish new markets for its weapons.
- o ~~(C)~~ Many weapons have been developed specifically for export, including NATO-standard ones such as the GMN-45 155-mm gun-howitzer look-alike, a copy of the U.S. M-16 rifle, and 5.56-mm ammunition.

~~(C)~~ The Chinese face a formidable task in integrating newly acquired technology into cohesive production programs. Supporting infrastructures such as raw materials supply, energy, and transportation services must be improved. The actual dynamics of defense industry modernization also depend on continuance of favorable domestic and external political conditions.

- o ~~(C)~~ Progress will probably be gradual for years to come and punctuated by occasional setbacks. Output of the defense industries will likely comprise military goods that embody low cost and incremental improvements in existing equipment. For the immediate future, China will emphasize the manufacture of export models. Aggressive marketing will be required to supplant the earnings realized as a result of the Iran-Iraq conflict, but prospects for the same high intensity of sales are not good.