CHINA-U.S. TRADE

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ISSUE DEFINITION

The improved political relationship between the United States and the People's Republic of China (P.R.C.), initiated by the Nixon Administration and furthered by the Carter Administration's decision to establish diplomatic relations, has spurred a rapid increase in Sino-U.S. trade. While still small relative to overall U.S. foreign trade, the volume of trade represents an abrupt shift from the no-trade policy that had been pursued since 1950. Despite the rapid expansion, outstanding issues remain as serious barriers to normalized trade. Resolution of those issues may require concession or accommodations by the Chinese leadership as well as action by both the U.S. Congress and the Executive Branch. However, the development of a new approach to foreign economic relations by the post-Mao Chinese leadership and the establishment of diplomatic relations have laid the ground work for a further expansion of commercial relations.

BACKGROUND AND POLICY ANALYSIS

With the P.R.C.'s entry into the Korean War in 1950, Sino-U.S. trade virtually ceased. While the volume of trade between the two countries had never been large, the United States had accounted for a significant portion of China's foreign trade during the first half of the Twentieth Century. In the early 1930s, the United States had become China's second largest trade partner, accounting in some years for over 20% of China's total trade turnover. This trading relationship continued immediately after the Communist takeover in 1949. In 1950, the Communists' first full year in power, two-way trade amounted to $191 million, 22.5% of China's total trade.

As a result of the Korean War, the Truman Administration took several steps first to restrict and then to end commercial ties with the P.R.C. The most important of these was a total embargo on U.S. exports to the P.R.C., declared in December 1950 under the authority of the Export Control Act of 1949. At the same time, the Secretary of the Treasury, acting under the authority of the Trading With the Enemy Act of 1917, issued the Foreign Assets Control Regulation, which blocked Chinese assets in the United States and placed a total embargo on imports from China. The cessation of trade was reinforced by Transportation Orders T-1 and T-2, issued pursuant to the Defense Production Act of 1950, which prohibited U.S.-flag air or sea carriers from carrying any cargo destined for the P.R.C. Bunkering in the United States of vessels calling at Mainland Chinese ports was also prohibited. On December 29, 1950, shortly after the U.S. actions, the P.R.C. Government issued a decree in which it assumed control over all U.S. property in China.

LEGAL BARRIERS

In subsequent years additional legal barriers to Sino-U.S. trade were erected. The most important of these were denial of most-favored-nation treatment (MFN) to imports from the P.R.C. and a prohibition on U.S. Export-Import Bank financing of U.S.-P.R.C. trade. The denial of MFN treatment was first included in the Trade Agreements Extension Act of 1951. The prohibition on Eximbank participation in trade with the P.R.C. and other

Communist countries was first enacted in the Foreign Assistance and Related Agencies Appropriations Act of 1964. Both measures were continued by various laws until 1975, when they were modified by the Trade Act of 1974 (P.L. 93-618) and the Export-Import Bank Amendments (P.L. 93-646) of 1974. The new laws condition the grant of MFN to non-market economy countries and their eligibility for U.S. Government credits on liberalization of restrictive emigration policies. MFN treatment is also conditioned on conclusion of a bilateral trade agreement.

The new restrictions embodied in the Trade Act and the Export-Import Bank Amendments came several years after the Nixon Administration had taken the first steps to remove barriers to U.S.-P.R.C. trade. From July 1969 to February 1972, a number of important changes in the Government's administration of commercial relations with the P.R.C. were made. Among the changes were the following:

Restrictions on travel to the P.R.C. by U.S. citizens were relaxed; foreign subsidiaries and affiliates of U.S. firms were permitted to trade in nonstrategic goods with the P.R.C.

Bunkering of ships from non-Communist countries carrying non-strategic goods to the P.R.C. was allowed; controls were removed on the use of dollars and dollar instrumentalities in transactions with the P.R.C.

U.S. carriers were permitted to transport goods authorized for consignment to the P.R.C. to non-P.R.C. ports; the embargo on exports to the P.R.C. was ended, and the P.R.C. was accorded the same treatment for export control purposes as the Soviet Union and some East European countries.

In February 1972, President Nixon made an offical visit to the P.R.C. At the end of his visit, he and the Chinese leadership issued the Shanghai Communique which formalized the new political relationship between the two countries. With regard to commercial relations, the Communique states: "Both sides view bilateral trade as another area from which mutual benefits can be derived and agree that economic relations based on equality and mutual benefit are in the interest of the peoples of the two countries."

Additional steps in the normalization of commercial relations followed. In November 1972, U.S. regulations were further modified to allow U.S. air carriers and ships to visit P.R.C. ports. A trip by Secretary of State Henry Kissinger to the P.R.C. in February 1973 resulted in the establishment of "Liaison Offices" in Peking and Washington. In May 1973, the National Council for U.S.-China Trade, a trade promotional organization composed of representatives from private business, was established with the encouragement of the Administration. The Carter Administration's decision to establish diplomatic relations with the P.R.C. announced on Dec. 15, 1978, removed probably the major barrier to normalization of commercial relations.

LEVEL OF TRADE

The improved political relationship and the relaxation of trade restrictions resulted in a dramatic increase in the volume of bilateral trade, the value of which increased from near zero in 1970 to over $900 million in 1974. Total 1978 trade turnover was approximately $1.1 billion. The rapid expansion reflects both inflationary effects and real increases in the volume of trade.

U.S.-P.R.C. Trade
(In millions of U.S. dollars)

Year	Total Trade	U.S. Exports to P.R.C.	U.S. imports from P.R.C.
1970	--	--	--
1971	5.0	--	5.0
1972	95.9	63.5	32.4
1973	805.1	740.2	64.9
1974	933.8	819.1	114.7
1975	461.9	303.6	158.3
1976	337.3	135.4	201.9
1977	374.0	171.3	202.7
1978	1,147.7	818.2	324.1
1979	2,308.8	1,716.5	592.3
1980	4,807.3	3,749.0	1,058.3

Until 1976 the United States accumulated large surpluses in its balance of trade with the P.R.C. This resulted, in large part, from the P.R.C.'s need to import a considerable volume of U.S. agricultural products -- primarily wheat, cotton, soybeans, and corn. Agricultural exports accounted for over 80% of U.S. exports to the P.R.C. in 1972, 1973, and 1974. In 1975, U.S. grain exports to the P.R.C. fell significantly, with the result that overall trade turnover was cut in half. The U.S. trade deficits with China in 1976 and 1977 were also largely the result of a reduction in grain sales. In 1978, the P.R.C. again began to import significant amounts of U.S. wheat, and, in 1980, the United States became the leading supplier of wheat to China. The large increase in two-way trade in 1978 also reflected an expansion of non-agricultural trade. The major non-agricultural exports have been aircraft and aircraft parts, oil-processing equipment, iron and steel products, aluminum and other non-ferrous metals, and chemicals.

In addition, the P.R.C. has signed contracts with a U.S. firm for eight entire ammonia plants valued at more than $200 million. By far the largest transaction is an agreement with U.S. Steel Corporation, signed in January 1979, to build a billion-dollar iron ore processing complex in China. U.S. automotive firms are negotiating possible ventures involving production of trucks and heavy-duty transportation equipment which may be even larger.

Of the small volume of P.R.C. exports to the United States, the most important items have been cotton textiles, and tin. In 1974, the United States imported 84.6 million square yards of textiles and apparel from China. Since then, the rapid growth has continued; in the first 10 months of 1978 imports totaled almost 180 million square yards valued at $118 million. China is now the sixth largest supplier of textiles to the United States. The rapid increase in imports from China led some industry spokesmen to demand import restrictions.

AGREEMENT ON PRIVATE CLAIMS

Since the establishment of diplomatic relations, U.S. and Chinese representatives have been intensively negotiating the outstanding legal and administrative barriers to trade. One of the major issues was the question of blocked Chinese assets and private U.S. claims against the Chinese Government, which had been a serious impediment to shipping, banking, and other aspects of commercial relations. (U.S. private claims against China were estimated to be $197 million, while blocked Chinese assets in the United States were valued at $76.5 million.) In 1973 Secretary of State William Rogers met with P.R.C Foreign Minister Chi Peng-fei in Paris to negotiate a settlement. They agreed in principle to a resolution, but no settlement was reached. In May 1977, it was reported that the Carter Administration had resumed negotiation on the claims issue. During a visit to China in March 1979, Secretary of Treasury Michael Blumenthal initialed an agreement with the Chinese Government. The agreement was officially signed during a subsequent visit to China by Secretary of Commerce Juanita Kreps in May 1979. The agreement provides that the Chinese Government will pay U.S. claimants $80.5 million by Oct. 1 1984 ($30 million of that total is to be paid by Oct. 1, 1979). The U.S. Government agreed to unfreeze $80.5 million of Chinese assets held in U.S. banks. However, at the insistence of the U.S. negotiators, the agreement does not take any position as to the ownership of the Chinese assets. Consequently, the Chinese may have difficulty in reclaiming some of their assets.

MOST-FAVORED-NATION TREATMENT

Another important barrier was the absence of most-favored-nation (MFN) treatment for Chinese exports to the United States. The Trade Act of 1974 prohibits extension of MFN to non-market economy countries that restrict emigration. The President may waive the requirement of free emigration for 18 months with Congressional approval, if he receives assurances that the waiver will promote free emigration. This procedure has been followed to extend MFN treatment to Romania and Hungary. The absence of MFN had a negative effect on the P.R.C.'s ability to export to the United States. It seems likely that the political significance of MFN is a more important consideration for them than potential economic gains. During her visit to China in May 1979, Secretary Kreps initialed a general bilateral trade agreement --- an important provision of which is extension of MFN to China. The agreement was officially signed on July 7, 1979.

On Oct. 23, 1979, President Carter submitted the bilateral trade agreement to Congress and used his waiver authority to extend MFN treatment to China. A concurrent resolution (H.Con.Res. 204) to approve the extension of MFN was passed by Congress on Jan. 24, 1980.

EXPORT CONTROLS

The Carter and Reagan Administrations have taken several steps to relax controls on exports to the P.R.C. On Apr. 25, 1980, the Commerce Department placed China in a separate category for export control purposes, according different treatment for exports to China than for exports to the Soviet Union and most other communist countries. On Sept. 12, 1980, the Commerce Department announced new, less stringent licensing guidelines for the P.R.C. The new guidelines permit approval of some exports with military end-uses.

On July 8, 1981, the Reagan Administration announced a liberalized export policy on dual-use, high technology exports to the P.R.C. According to Deputy Assistant Secretary of Commerce for Export Administration Bo Denysyk, the policy will reduce administrative restrictions by providing "a presumption of approval for products with technical levels twice those previously approved." The Administration later announced the availability of "project licenses" for exports to China. Project licenses expedite the export licensing process by providing approval for U.S. assisted projects in China which involve equipment and technology requiring validated licenses.

Export Credits and Investment Guarantees

Until recently, the Chinese leadership did not show the same interest in credits as other Communist countries. However, in recent years, Chinese leaders have moderated their policy of avoiding long-term indebtedness to foreigners and have accepted some "deferred payments"--short- and medium-term credits--for purchase of complete plants. The Agricultural Trade Act of 1978 (P.L. 95-501) was passed by the 95th Congress and signed by President Carter. Among other provisions, the Act makes the P.R.C. eligible for three-year agricultural credits from the Commodity Credit Corporation.

Chinese eligibility for U.S. Eximbank credits was not provided for in the bilateral trade agreement signed on July 7, 1979. However, Vice-President Mondale, during his Aug. 1979 visit to China pledged Administration support for an effort to make Eximbank credit assistance available to the P.R.C. Subsequently, in April 1980, President Carter determined that it is in the national interest for Eximbank to extend export credits to China.

Until recently, the P.R.C. Government followed a very restrictive approach to any kind of foreign involvement, such as foreign investment or industrial cooperation, in the Chinese economy. Foreign businessmen and technicians were allowed to visit industrial projects only rarely. This policy appears to be changing. Foreigners are traveling to China in greater numbers, and official Chinese statements suggest that foreign direct investments will be allowed. If the Chinese government is willing to accept private direct investment by foreigners, U.S. firms may be assisted by the Overseas Private Investment Corporation (OPIC), a U.S. Government agency which insures U.S. investors overseas against political risks. Two bills (H.R. 5252 and S. 1916) were introduced in the 96th Congress which would allow OPIC to insure U.S. foreign investments in China. The bills were subsequently passed, and President Carter signed the measure into law (P.L. 96-327) on Aug. 8, 1980.

OTHER BILATERAL AGREEMENTS

On Jan. 22, 1979, representatives of the U.S. and Chinese governments met in Washington, D.C. to discuss textile trade. Subsequently, the textiles issue was discussed by the two governments on several occasions. U.S. officials pressured the Chinese to sign an orderly marketing agreement (i.e., quantitative restrictions) on imports of Chinese textiles. In the absence of an agreement, the U.S. government unilaterally imposed a quota on Chinese textile imports. After prolonged negotiations the two sides finally reached agreement on the terms of an agreement. On July 24, 1980, the U.S. Trade Representative's office announced that an agreement in principle had been initialed. The agreement was formally signed in Washington, D.C. on Sept. 17, 1980. The agreement, which is effective from Jan. 1, 1980 to Dec. 31, 1982, provides for the orderly import of Chinese textile and apparel products made of cotton, wool, and synthetic fibers.

Three other bilateral agreements were signed on Sept. 17, 1980: A civil aviation agreement provides for regularly scheduled direct commercial flights between the United States and China; A maritime agreement provides for port access and cargo sharing; And, a consular agreement authorizes both countries to open three more consulates.

In October 1980, Representatives of the two countries signed a 4-year grain supply agreement. The agreement, which came into effect Jan. 1, 1981, provides for the sale of between 6 million and 9 million metric tons (mmt) of grain annually. Purchases by China above 9 mmt require the approval of the U.S. Government.

CHINESE TRADE POLICY AND PROSPECTS FOR FUTURE TRADE

Political issues have played an important role in China's foreign trade policy. For example, there is evidence that Chinese importers have discriminated against countries with which China has not had good diplomatic relations. In particular, the United States appears to have been a market of last resort in Chinese grain purchases. This policy suggests that the establishment of diplomatic relations between the United States and China may be followed by a significant increase in bilateral trade.

Chinese domestic politics have been an important determinant of the level of foreign trade and will probably heavily influence the course of U.S.-Chinese trade. Before his death, Premier Chou En-lai and his chief administrator on economic affairs, Vice-Premier Teng Hsiao-ping, promoted a program to rapidly modernize the Chinese economy. Their program, consisting of an intensive drive to modernize Chinese agriculture, industry, national defense, and science and technology, was designed to make China a modern industrial power by the year 2000. On the industrial front, the modernization drive emphasized expanded production through hard work and stricter managerial authority, increased attention to the living standards of workers, and the systematic import of technology to from abroad. After the deaths of Chou En-lai and Mao Tse-tung, this program became a prominent issue in the succession struggle. The radical faction in the Chinese leadership, led by the so-called "Gang of Four," denounced the use of material incentives, the diminution of the Party's role in the economy and dependence on foreign technology. In September 1976, the leaders of the radical faction were arrested. The ascent to power of the moderate faction, led by Premier Hua Kuo-feng and Teng Hsio-ping, was followed by renewed emphasis on economic modernization.

A key element of the modernization program is an expansion of Chinese foreign trade. Major emphasis is being placed on the import of equipment and technologies for oil exploration, coal mining, steelmaking, electronics, chemical fertilizer, power generation, and the petrochemical industry. Other imports include grain, crop seed, farm animals for breed-stock, and small amounts of consumer goods.

A review of economic performance in 1979 convinced Chinese economic planners that their modernization drive was proceeding too rapidly, and that available resources would not support the massive capital construction projects that were underway. Consequently, they decided to retrench somewhat from the ambitious modernization program and proceed more cautiously. One result of this decision was a temporary suspension of some import contracts signed with Japanese firms and a slowdown of commercial negotiations with other foreign companies.

U.S. firms wishing to do business with the P.R.C. face many practical problems because of their general unfamiliarity with Chinese foreign trade practices. This is complicated by the P.R.C.'s isolation from the international economic system. There are few opportunities for Western businessmen to contact Chinese exporters and importers; business contacts have been limited primarily to the Canton Trade Fair, held twice a year. Recently, this situation has been changing. For example, a number of U.S. business executives have visited Peking to conduct negotiations on sales of oil exploration and drilling equipment, minerals and metal processing equipment, and petrochemical machinery and technology. American technicians were involved in the installation of the ammonia plants.

Even with the removal of major political and legal barriers, there are serious economic constraints on the P.R.C.'s ability to expand rapidly its volume of trade with the United States. The most important constraint is the P.R.C.'s increasing difficulty in earning sufficient hard currency to pay for its import needs. Export growth is unlikely to keep pace with the import needs implied by China's modernization program and its periodic need for grain imports. The gap between export potential and import needs provides a strong motivation for Chinese acceptance of more trade credits.

Moreover, in the long-run, increases in U.S. high-technology exports to the P.R.C. may be offset by a smaller volume of agricultural exports. In allocating their scarce hard-currency reserves, Chinese planners will probably show preference to industrial imports, while placing emphasis on developing self-sufficiency in agriculture. Naturally, a reduction of agricultural imports depends on the P.R.C.'s ability to expand rapidly domestic agricultural production. Recent fluctuations in domestic grain production attest to the difficulty of achieving this goal in the short run. Nevertheless, the long-run Chinese goal appears to be to avoid the kind of large purchases of agricultural products that inflated U.S.-P.R.C. trade totals in some recent years.

One bright spot in the P.R.C.'s foreign trade situation is the potential for large exports of oil. The P.R.C.'s proven plus probable reserves are conservatively estimated at 5.9 billion metric tons and could easily be 7.6 billion metric tons. Offshore reserves will add appreciably to these estimates. Production has expanded rapidly during the 1970s, and, by 1985, the P.R.C. could be producing in excess of 200 million metric tons. Thus, in the future, the P.R.C.'s earnings from oil exports could ease its balance of payments constraint. To realize its potential as a major oil exporter, the P.R.C. will probably have to import considerable amounts of Western machinery, equipment and technology.

The P.R.C. also has reserves of other raw materials, such as natural gas, coal, and iron, which could provide large exportable surpluses in the future. However, the development of those resources and the establishment of sufficient processing and transportation facilities appear to be a longer term prospect.

In making decisions affecting U.S.-P.R.C. trade, U.S. policymakers should consider a number of important questions:

Is the P.R.C. a potentially attractive source for U.S. imports of oil and other raw materials?

Should the P.R.C. be treated differently from the Soviet Union in U.S. foreign trade policy, particularly in relation to official credits and most-favored-nation treatment?

Do high-technology exports to the P.R.C. represent a threat to U.S. national security?

Will occasional Chinese agricultural purchases have a destabilizing effect on domestic supplies and prices?

Are U.S. trade concessions likely to be an effective means for influencing domestic political stability and the process of succession in China?

Can the United States use trade to influence great power relations in East Asia?

Would U.S. export of high-technology to the PRC have a stabilizing or destabilizing impact on the Northeast Asian balance of power?

What commercial benefits might accrue to the United States as a result of more liberal trade policies toward the PRC?

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CHRONOLOGY OF EVENTS

08/08/80 -- President Carter signed P.L. 96-327, which makes available to U.S. investors in China the insurance programs of the Overseas Private Investment Corporation.

07/24/80 -- The U.S. Trade Representative's office announced that an agreement in principle had been signed with China which would limit imports of Chinese textiles.

01/24/80 -- H.Con.Res. 204, approving extension of MFN for China was passed by Congress.

10/23/79 -- President Carter sent to Congress a proclamation extending most-favored-nation treatment (MFN) to China. The extension of MFN must be approved by Congress.

08/00/79 -- Vice President Mondale visited China and pledged that the Administration would submit the U.S.-Chinese trade agreement for Congressional approval by the end of 1979.

07/07/79 -- U.S. and Chinese representatives signed a bilateral trade agreement in Peking.

12/15/78 -- President Carter announced the establishment of diplomatic relations with the P.R.C.

08/22/77 - 08/26/77 -- Secretary of State Cyrus Vance made an official visit to the P.R.C.

06/22/77 -- President Carter signed the Export Administration Amendments of 1977.

05/01/77 -- The New York Times reported that U.S.-P.R.C. negotiations to settle financial claims between the two countries had resumed.

10/27/76 -- Diplomats in Peking reported that China's fifth five-year plan would begin early in 1977.

09/09/76 -- The death of Chairman Mao was announced officially in Peking.

04/07/76 -- Hua Kuo-feng was promoted to Prime Minister and first chairman of the Communist Party.

01/08/76 -- China's Premier Chou En-lai died.

12/01/75 -- President Ford began a visit to the P.R.C.

09/08/75 -- A Chinese foreign trade mission, after visiting various parts of the United States, met with President Ford and congressional leaders.

01/28/75 -- Secretary of Agriculture Earl Butz said that the P.R.C.'s cancellation of wheat orders from the United States was probably due to a good domestic wheat crop in China and an unfavorable foreign exchange situation.

01/26/75 -- The P.R.C. cancelled an order for 601,000 tons of U.S. wheat.

01/03/75 -- Trade Act of 1974 (P.L. 93-618) was enacted.

11/25/74 -- Secretary of State Henry Kissinger began his seventh visit to the P.R.C.

04/04/74 -- President Ford named George Bush to head the U.S. Liaison Office in Peking.

04/02/74 -- Senator Mike Mansfield introduced S. 3285, a bill to extend most-favored-nation treatment to the P.R.C.

04/20/73 -- P.L. 93-22 enacted authorizing the President to extend diplomatic privileges and immunities to the Liasion Office of the People's Republic of China.

03/02/73 -- Secretary of State William Rogers announced "an agreement on principle" on question of frozen Chinese assets in the United States and private U.S. claims against the P.R.C. Government.

02/22/73 -- The U.S. and the P.R.C. agreed to open "liaison offices."

11/22/72 -- President Nixon lifted a 22-year ban on travel by U.S. aircraft and ships to China.

07/05/72 -- The Boeing Corporation announced that it had received an export license to sell $150 million in commercial jets to the P.R.C.

02/14/72 -- President Nixon further relaxed controls on U.S. exports to the P.R.C., giving it equal treatment with regard to export controls to the Soviet Union and various East European countries.

02/00/72 -- President Nixon visited the People's Republic of China.

04/14/71 -- President Nixon announced a relaxation of the embargo on trade with the P.R.C. Specific items of a non-strategic nature were permitted for export to the P.R.C. without a validated license. Other measures were announced to facilitate travel by Chinese citizens to the United States and shipping between the two countries.

12/19/69 -- Foreign subsidiaries of U.S.-owned firms permitted to engage in trade of non-strategic items with the P.R.C.

07/21/69 -- Department of State announced relaxation of restrictions on travel by U.S. citizens to the P.R.C.

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