The Heritage Foundation Backgrounder

No. 77

The Heritage Foundation • 214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202)546-4400

March 7, 1979

CHINA: THE MYTHICAL MARKET

INTRODUCTION

With the "normalization" of U.S.-Chinese relations and the various overtures resulting therefrom, much discussion has focused on an expansion of U.S.-PRC trade. Following his address to the nation on December 15, 1978, announcing establishment of diplomatic relations between the United States and the PRC, President Carter went on to tell reporters:

> I think that one of the greatest benefits that will be derived from this is...a new vista for prosperous trade relations with almost a billion people in the People's Republic of China.

Shortly after the President's address, Treasury Secretary Michael Blumenthal predicted a rapid growth in trade between the two nations. This was followed quickly by warnings from Secretary of Commerce Juanita Kreps against over-optimistic expectations for immediate materialization of new trade opportunities. Unfortunately, the flurry of announcements of new contracts or negotiations with the PRC during the month of January has overshadowed what must be considered difficult and delicate obstacles preventing substantial two-way trade expansion.

Factors hindering future U.S.-PRC economic relations are addressed in this paper in the context of the state of the Chinese economy, Chinese trade practices which vary from normal western routine, and existing American legislation. An overview of the recently much-discussed "Japanese formula" and a look at the prosperous Taiwanese economy serve to further sustantiate claims that the only realistic attitude one can adopt towards expanded short-term and long-term U.S.-PRC trade, and any perceivable gains, is skepticism. Moreover, while the list of unanswered questions surrounding the PRC's possible entrance into the international arena of trade and finance proliferates, so does the list of potential conflicts this entrance may provoke for U.S. foreign economic policy.

ECONOMIC PROGRAMS OF THE PRC

Although China occupies the third largest land mass in the world (after the Soviet Union and Canada), her agriculture and population of 950 million are concentrated in one-fifth of the country's surface area. It is estimated that at least 80 percent of China's workforce is still engaged in relatively primitive agricultural production. The following brief overview of development policies since 1950 sheds some light on the poor state of the economy. Moreover, illustrations of the PRC's present infrastructure seriously contradict current forecasts for rapid Chinese modernization and a sudden trade boom.

The mainland Chinese reasserted an autarchic philosophy in their economic policies of the early 1950s. Internal political doctrines dominated all activities and strengthened in the face of world political isolation. The year 1950 marked the beginning of the Korean War and a U.S. trade embargo imposed against the PRC. In the 1950s private enterprises were increasingly subject to state control as the PRC leadership rationed capital, allocated raw materials, and encouraged government enterprises to compete intensely with private industries. Land reform programs harboring economic, social, and political objectives were instituted. Collectivization became a reality with fifteen percent of Chinese farmland and families in agricultural cooperatives by mid-1955, and by spring of 1965 nine-tenths of the peasant population had been forced to join cooperatives.[1]

While generally adhering to policies of self-reliance the PRC also leaned toward the Soviet Union for capital imports of both economic and military goods in the mid 1950s. The Soviets extended credits totaling between $1.4 and $2.2 billion to the Chinese, all of which were repaid by 1965, primarily in meat and oil exports.[2] With eastern nations accounting for close to 85

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1. John K. Fairbank, The United States and China (Cambridge: Harvard University Press, 1971), p. 358.

2. Alexander Eckstein, China's Economic Revolution (Cambridge, England: Cambridge University Press, 1977), p. 237.

percent of the PRC's total trade in the 1950s, it is not surprising that by 1959 the Soviet Union had captured over 50 percent of the Chinese trade.

Soviet influence on the mainland's economic development appears in the principles adopted for the First Five Year Plan (1953-1957). Stressing the development of heavy industry, 58 percent of the funding was allocated to industrial expansion with only 8 percent delegated for agricultural improvement.[3] The relative neglect of agriculture combined with a transportation bottleneck and a poor harvest cancelled any gains from industrial growth. This first plan witnessed China's haste for modernization in adopting a plan based on the Soviet Union, a nation whose economic resource base was much greater than that of the Chinese from the start.

"ECONOMIC" POLICY SLOWLY EMERGES

The opening of the biannual Canton Trade Fairs in 1956 signaled the fear on the part of the Chinese that they were sacrificing their self-reliance through dependency on the Soviet Union. These trade fairs became an important source of exposure to modern commerical developments for the Chinese and for many nations were the only opportunities for business contact within the PRC.

Mao Tse-tung by his own admission concentrated his efforts prior to 1958 on revolutionary change and therefore contributed little to industrial planning. In 1958 the Great Leap Forward, referred to as "walking on two legs," was initiated, but died shortly thereafter in 1960. The program proclaimed a goal of output expansion in all sectors of the economy through indigenous production methods and utilization of the abundant labor resources. However, when agricultural production faltered severely, and disrupted the inter-industry balance, the program was abandoned.

In 1962, Chou En-lai, in a speech before the National People's Congress, expounded upon the necessity of agriculture by pronouncing a policy of "Agriculture First." Realization of this objective, according to Chou En-lai, required reordering of planning priorities, a slowdown in the investment rate and, surprisingly, the use of material incentives to motivate farmers.[4] Here was the first example of the ideological conflicts which would develop as a centrally planned economy faced modern economic realities.

Since 1962 the majority of China's trade has been with Western nations. Despite attempts to increase agricultural output, China

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3. D. J. Dwyer, China Now (Longman Group, Ltd., 1974) p. 34.

4. Eckstein, op. cit., p. 60.

became an importer of wheat along with industrial raw materials and cotton materials in the early 1960s.

The Cultural Revolution, dating from 1966 to 1969, disrupted industrial production, transportation services, and foreign trade with little adverse affect on the agricultural sector. During this period Mao Tse-tung, discontent with the Chinese educational system, closed all the schools and universities and purged technical personnel from the government. The "lost generation" of education from 1966 to 1976 now burdens the PRC's development efforts with a profound lack of skilled manpower and trained technicians. Economic policies were again subordinated to political considerations.

REOPENING OF THE ECONOMY

Looking toward more "flexibility" in pursuit of the same policy of self-reliance, the PRC in the early 1970s again expanded its foreign trade. In 1972, the Technical Export-Import Corporation was reactivated. Between 1972 and 1974, this corporation contracted orders for an estimated $2.5 billion in industrial facility imports.

Serious attention given to restructuring Chinese economic planning by Chairman Hua Kuo-feng resulted in the Four Modernizations Program, first introduced in 1975 by Premier Chou En-lai. This program maintains growth in agriculture, industry, national defense, and science and technology will raise China among the ranks of the world's industrialized powers by the year 2000.

The current Ten Year Plan, originally drafted by Teng Hsiao-ping in 1975, was an outgrowth of conferences designed to further the objectives of the Four Modernizations and provides guidelines for completion of the Fifth and Sixth Five Year Plans through 1985. Growth targets projected in the plan include a 4 to 5 percent yearly increase in total agricultural output and an annual output in grain of 400 million tons by 1985 (a 43 percent increase over the 1977 output). All phases of the infrastructure are to be expanded with an annual 10 percent growth in industrial output expected. A specific target of 60 million tons of steel production per year by 1985 has been demanded. The most ambitious plans call for the completion or new construction of a total of 120 major projects by 1985, including ten steel plants, eight coal mines, ten oil and gas fields, thirty power stations, five harbors, and six trunk railways. The cost of the entire Ten Year Plan is estimated at $600 billion, requiring over $75 billion in capital imports.[5]

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5. U.S. Department of Commerce, "China's Economy and Foreign Trade, 1977-78," p. 3.

ECONOMIC DEVELOPMENT - AN ONGOING BATTLE

The examination of the development policies formulated by the PRC officials during the past three decades illustrates that the Chinese acknowledge the various weaknesses of their economy, yet the number of remaining unsolved problems is staggering. The examples offered below typify the problems plaguing the formation of a sound infrastructure.

With respect to agricultural development, Hu Ch'iao-mu, a former confidant of Mao and the president of the Academy of Social Sciences recently stated that the average per capita food grain production in 1977 equaled that of 1955. Considering the increasing emphasis being given to agriculture in the development plans of the PRC, this statistic is alarming. Furthermore, while grain output in 1978 was 10 million metric tons above the 1977 level, the improvement was not sufficient to meet the goal set forth in the Ten Year Plan.[6] More stringent efforts must be taken to promote self-sufficiency in food commodities.

A January CIA report provides no reassurances for miraculous Chinese economic growth. The report concluded that even if China achieved an annual gain of 6 percent in GNP, by the year 2000 its GNP would still be 15 percent below that of the U.S. in 1975.[7] But agricultural production is not the only sector lagging in output expansion.

The transportation sector of a developing country is critical to the massive distribution of basic foodstuffs and in linking all sectors of the growing economy. While the railroads in the PRC have doubled in track size since 1952, the system is still one-sixth the size of the U.S. rail network. As compared to 3.1 million miles of paved roads in the U.S., the PRC has only 161,000 miles. Air passenger miles are also negligible in the PRC, one billion as compared to 193 billion in the U.S. Shipping is another facet of the transport system in the PRC which requires immediate attention. It is revealing to note the discussion that recently took place in San Francisco between the Mayor, the Port Authorities, and the PRC mission delegates from Washington. San Francisco is being considered as the site for the West Coast Chinese consulate, thought to be necessary to facilitate shipping. According to the San Francisco Port Authorities, their city may be selected because of its slow development in the field of containerized shipping equipment. The lack of modern shipping capabilities by China necessitates the use of freighter ships; thus the old finger ports of San Francisco, not yet renovated, may prove useful again. This type of

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6. World Business Weekly, January 8-14, 1978, p. 48.

7. Fox Butterfield, "China's Road to Progress is Mostly Uphill," The New York Times, February 4, 1979.

inconsistency, with the PRC contracting for the most advanced equipment in areas of electronics, consumer transportation, and agricultural machinery at a time when the transportation inadequacies prevent efficient distribution of all goods within the economy, signals a dangerous attempt on the part of the PRC officials to modernize too quickly. Balanced growth is a difficult policy to achieve under the guidance of a free market economy, much less under a slightly modified centrally planned economy.

John Fairbank, often regarded as the dean of American sinologists, cautions that

> industry has to go to the villages and the economy of mass production in central cities must be foregone because no feasible transport system could possibly deliver the goods to 800 million consumers. The villages have to industrialize "in situ."[8]

Lastly, fertilizer plants purchased by the PRC in 1973 and 1974, all scheduled to be in full production at this time, operate at only 50 percent capacity. This raises questions about similiar delays in other sectors of industry. Should, for instance, power plant construction or other fundamental sectors of the infrastructure be subject to these delays, the Chinese will be unable to cope with the mass industrialization now required to finance their surge in capital imports.

Christopher Phillips, president of the National Council for U.S.-China Trade has found the Chinese economy itself to be a hindrance to American business expansion in the PRC. He recently stated

> the technological absorption process will be a tough one for China, the realities of which should not be underestimated by American companies...technology is ten to twenty years behind the state of art in the U.S.[9]

From all outward appearances the PRC is attempting to modernize rapidly through industrialization. However, a potential urban/rural controversy, which often arises in this stage of developing economies, must now be addressed by the government. Once again, John Fairbank cogently expounds upon this prospective problem:

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8. John K. Fairbanks, "The New Two China Problem," The New York Review of Books, March 8, 1979, p. 4.

9. Christopher Phillips, "The China Trade--How Big A Boom?", Christian Science Monitor, February 13, 1979, p. 27.

> In the midst of plans for steel, coal, and oil production to build up industry, we have to wear bifocals that can also keep in view the rural 800 million. They have doubled in numbers since 1949 but are still bone poor. If the new city elite that we help to train should lose touch with the village, Mao's ghost may well appear and cry "Remember me!" in more than one rural hamlet. Literacy and transistors are spreading expectations among the most cohesive and the largest bloc of people ever to appear on earth.[10]

In 1977 the lowest paid 50 percent of urban industrial workers in the PRC reportedly received their first general wage increase in 20 years. Should this trend continue, Fairbank's scenario may quickly materialize.

The discrepancies in gains from industrialization accorded urban and rural workers in many developing nations is particularly relevant as one observes the internal economic turmoil in Iran. The failure here to adequately and expediently distribute the oil revenues within the economy contributed significantly to unrest and industrial strikes. The Chinese economy is not immune from such economic disasters and, furthermore, all predictions for future Chinese trade relations assume internal political stability, a stability that has seldom existed since the founding of the PRC.

PRC TRADE PRACTICES

Apart from the discrepancies facing American businessmen in China due to technological and infrastructure inferiority, there are several Chinese trade policies which may complicate what has been routine practice with most other nations. For instance, the PRC has no income tax applicable to foreign earnings. This has raised much discussion by the American oil companies, in particular, who will be anxious to claim Chinese taxes against U.S. payment obligations.

In addition, Westerners may find the Chinese contracts complicated in some cases and vague in other instances. Most Chinese commercial contracts for foreign goods include an inspection clause requiring examination at every port by the Chinese Commodity Inspection Bureau for quality, quantity, weight, etc. Other contracts require a guarantee on the part of the seller for "satisfactory

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10. Fairbanks, "The New Two China Problem," p. 3.

performance" over an extended period of time. What the Chinese producers and American producers consider "satisfactory" is likely to differ. Penalties for late delivery of capital goods, regardless of the cause, are a source of probable contention. The international application of "force majeure" for exemption from late fees should apply, although the Chinese have not always been eager to define what they consider applicable under this heading.

Lastly, the Chinese desire to avoid litigation in western courts and their preference for negotiated solutions may hinder claims by American businesses in settlement of trade disputes. Here the lack of informal trade contacts between the Chinese and American businessmen will be an obvious disadvantage for Americans.[11]

FINANCE -- THE LINCHPIN OF PRC ECONOMIC GROWTH

The ultimate determinant of how quickly the PRC will attain the status of an industrialized nation and (perhaps more critically for the U.S.) how rapidly the nation will penetrate the world markets, is her financial capability. The PRC's history of credit is impressive because until recently the nation has advocated a cash-only purchase policy with few exceptions. Limited current reserve assets of an estimated $2 billion and the assumption of the part of Chinese officials and American bankers and businessmen that Chinese oil exports will assume the major responsibility of financing capital imports, narrow the prospects for rapid economic growth.

Illustrative of the degree to which financial weakness exacerbates the problems of coordinated economic expansion is China's need for agricultural imports. A reported 80 percent of U.S. exports to the PRC in 1972, 1973, and 1974 consisted of agricultural goods, primarily grains.[12] The PRC purchased an approximate $500 million in American grains in 1978 and have stated their intention to purchase between 5 and 6 million metric tons of grain yearly from the U.S. through 1982. Public Law 95-501, which extends the authority of the Commodity Credit Corporation to finance credits for agricultural purchases by the PRC, appears timely, yet these expenditures by the PRC in lieu of purchases of capital goods increases the necessity of buying high technology on credit. Inadequate indigenous food supplies, so often a curse of developing nations, must be overcome by the PRC.

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11. Testimony of Stanley Lubman at 1971 Senate hearings as reported in _China and United States Foreign Policy_ (Washington, D.C.: Congressional Quarterly, 1973), p. 87-88.

12. Holliday and Hardt, "China-U.S. Trade (Library of Congress, Congressional Research Service, January 11, 1979, p. 33.

Another prominent example of the linkage of finance to all sectors of the economy deals with what the Chinese can export in sufficiently large quantities in order to gain currency to meet credit payments. Reliance primarily on Chinese oil exports appears questionable, not only because this industry suffers from a lack of technology, skilled labor, and financing as so many others in the PRC economy, but, more importantly, domestic demand for energy resources will undoubtably increase proportionately with industrial growth. Thus, in the early stages of economic expansion, the PRC must exploit its available resources internally. Additionally, a large percent of Chinese oil exports, expected to range under ten percent of future total production, is committed to Japan as payment for previously contracted capital imports.[13]

A potentially explosive trade dilemma involves the exportation of fabric and cotton materials by the PRC. In 1978 the PRC was the sixth largest supplier of fabrics to the U.S. and the largest source of American cotton imports, all under effective high rates of tariff. While the PRC naturally seeks to expand textile exports as a means of acquiring foreign currency, the world markets in this commodity are already congested. In 1975 American domestic textile producers protested bitterly against unfair foreign competition such as the textiles entering the U.S. from Taiwan under MFN status. The Taiwanese textiles are currently subject to voluntary restraints established in the 1974 Multi-Fibre Agreements (recently extended). Furthermore, the PRC has not been willing to limit its export supplies along voluntary restraints. This question is complicated further should the PRC decide to interfere with Taiwan's membership in GATT and the adherence by Taiwan's producers to the various trade policies of the organization. With the MTN package soon facing Congress the domestic textile producers will once again bring pressure to bear upon the President to enforce severe protectionist policies. The U.S. market for Chinese textiles may thus be closed more tightly and international pressures may depress a source of foreign currency earnings for the PRC.

The doubts surrounding the PRC's financial capacity are heightened when one sees how quickly the PRC is adapting to the system of credit. A consortium of British banks has reportedly extended a $1.2 billion credit to the PRC for industrial development over a five-year period at 7 1/4 percent interest and there have been reports of French credits available to the PRC over a ten-year period totaling $6.8 billion at 6 1/2 percent interest. Secretary of the Treasury Blumenthal, at a Department of State briefing on U.S. trade prospects with the PRC, projected into the future when American banks may directly extend credits to the PRC:

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13. For a detailed analysis of Chinese oil supplies, see "Chinese Oil: Problems and Prospects," Heritage Foundation <u>Backgrounder</u> No. 72 (January 22, 1979).

> If anyone thinks the relationship will be based on massive extensions of credit without adequate assurance of repayment, I assure you that it is not our intention.[14]

With 1978 import contracts totaling $29 billion, nine times the amount purchased by the PRC between 1972-1977, the short-term credit extension business appears booming, yet the question of repayment still looms.[15]

After reviewing the above Chinese economic policies and existing economic weaknesses one must next examine the specific U.S. economic relations with the PRC, encompassing a brief historic overview, a look at legislative barriers, and prospects for future trade between the two nations.

HISTORIC OVERVIEW

The United States economic relations with mainland China began in 1784 with the launch of the first Yankee Clipper ship from New York en route to China. Attraction to the China market spread quickly and in 1842 the British and Japanese signed the Treaty of Nanking which granted Britain control over Hong Kong and several mainland ports. Not to be denied equal access to China, the U.S. signed a treaty with the Chinese in 1844 extending U.S. "extra-territorial" rights to China. In the mid 1800s, U.S. pursuit of Asian trade was carried out under the auspices of Manifest Destiny followed in the late 1800s with American exploitation of the "Open Door" policy.[16]

In the 1930's U.S. investment in China, which was only direct investment, totaled less than a quarter of a billion dollars. During this period, however, the U.S. became China's second largest trading partner, at times monopolizing 20 percent of China's total trade. Prior to 1934, U.S. aid to China had been ostensibly private, flowing through foundations and private concerns. In 1934, the U.S. government created a silver purchase program whereby China would supply the U.S. with silver, which it possessed in relatively large quantities, in return for U.S. dollars or gold. Between 1937 and 1939, the U.S. paid $184 million to Nationalist China through the silver account.[17] With the approach of World War II, the U.S. extended aid to China on a government basis. Loans were granted prior to Pearl Harbor and the U.S. government covertly financed Colonel Chennault's "Flying Tigers." In 1942 a continued

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14. China Post, January 17, 1979, p.9.

15. Norman Pearlstine and Flora Ling, "The China Trade--a note of caution," Forbes, February 5, 1979, p.33.

16. Marvin Kalb and Elie Abel, Roots of Involvement--The U.S. in Asia 1794-1971 (New York: Norton, 1971), p.21.

17. Fairbank, The United States and China, pp. 301-303.

support program extending equipment, technical information, and financing began with a $500 million credit with no strings attached extended to Chinag Kai-shek by the U.S. government.

Upon the retreat of Chiang to Taiwan in 1949 and the Communist Chinese attack of U.S. forces in the Korean War, the U.S. severed all economic relations with the People's Republic of China. In 1950, President Truman declared a total embargo on U.S. exports to the PRC pursuant to the Export Control Act of 1949. Further, under the Trading with the Enemy Act the Treasury Department invoked a Foreign Assets Control regulation, freezing what is now estimated as $76.5 million of PRC claims in the U.S. In retaliation the Chinese froze approximately $196.5 million of U.S. corporate and private claims.

Prior to Richard Nixon's visit to China in 1972, U.S.-China economic restrictions were gradually lifted. In 1969, restrictions on American travel to China were eased and American tourists were allowed to purchase up to $100 of Chinese goods. In December 1969 the U.S. government abolished limits on the kinds of items tourists could purchase and permitted American subsidiaries abroad to trade in non-strategic goods with the Mainland. In 1970, the State Department further relaxed the travel ban. A selective export licensing of American-made components for non-strategic foreign goods destined for China was announced. Restrictions prohibiting American oil companies abroad from allowing foreign ships containing cargo of non-strategic goods en route to and from China to refuel were lifted. In a specific incident the U.S. Commerce Department in 1970 approved the sale of 80 dump trucks containing General Motors parts by an Italian company to the PRC.

On April 14, 1971, President Nixon revoked the 21-year trade embargo with the PRC. In an immediate response United Airlines petitioned the Civil Aeronautics Board for permission to establish a route to Peking, Shanghai, and Canton. Furthermore, in 1971 Secretary of the Treasury John Connally announced a general license permitting the use of U.S. dollars in transactions with the PRC. In June forty-seven items were cleared for exportation to China, including farm and forestry products, chemicals, textiles, selective metals, fertilizer, industrial equipment, automobiles, consumer goods, unsophisticated computers, and construction equipment (contrary to Department of Defense wishes). Following President Nixon's trip the U.S. liaison office opened in May 1973 with David Bruce acting as U.S. liaison officer in Peking.

The Agricultural Export Trade Expansion Act of 1978 passed by the 95th Congress permits the Commodity Credit Corporation to finance commercial sales of agricultural commodities to the PRC under both the deferred payment plan and the short-term export credit sales program, not to exceed three years. Passage of this bill appears timely as the U.S. Department of Agriculture predicted a fifty percent increase in the amount of grain imported by the PRC in fiscal year 1979, an estimated 13 million tons, with the U.S. supplying a substantial share. The PRC is predicted to become the world's largest wheat importer in fiscal year 1979.[18] U.S. grain sales have fluctuated severely in the early 1970s as China looked to Canada and Australia for the majority of its imports. With the new CCC regulations, however, the Americans should enjoy prosperous grain trade with the PRC.

U.S. LEGISLATIVE BARRIERS TO U.S.-PRC TRADE

Currently in force are four legislative acts which limit the types and amount of trade the U.S. may conduct with the PRC. Three of these, the Johnson Act, the Foreign Assets Control Regulations, and the Export-Import Bank Amendments deal with the financial arrangements of trade, while the Trade Act of 1974 contains restrictions dealing with the granting of most-favored-nation (MFN) status to foreign countries.

THE JOHNSON ACT

The Johnson Act, entitled "Financial Transactions with Foreign Governments" (PL 80-722, 1948) prohibits any individual, partnership, corporation or association within the United States, other than public corporations created by congressional authorization, from extending any loans or purchasing/selling bonds of a foreign government which is in default of obligations to the U.S. This restriction is lifted, however, if the foreign government is a member of both the International Monetary Fund (IMF) and the World Bank (IBRD). In recent hearings before the Senate Finance Subcommittee on Taxation and Debt Management, Assistant Treasury Secretary Fred Bergsten listed "political" debt arrearages by China at $49.8 million, from four Export-Import Bank loans in 1946.[19] Although U.S. banks in the fifty states are prohibited from negotiating loans with the PRC, their foreign affiliates may join other banks in the extension of Eurodollar loans and credits.

In order to escape the provisions of the Johnson Act the PRC may make a headstrong attempt to join the IMF and IBRD. This will raise serious questions as Taiwan is currently a member of both, and obligated to repay $60 million for its IMF quota, withdrawn many years ago. Will the PRC be willing or able to assume Taiwan's debts?

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18. U.S. Department of Agriculture, World Agricultural Situation, December 1978, p.26.

19. "Foreign Nations' Debt to U.S...." Wall Street Journal, February 2, 1979.

RESOLUTION OF FROZEN FOREIGN ASSETS PROBLEM

President Truman in 1950 enforced the provisions of the Trading with the Enemy Act to freeze the existing Chinese assets in the U.S. These regulations are operated by the Office of Foreign Assets Control in the Department of Treasury. With $196.8 million of U.S. claims frozen in Peking and $76.5 million of blocked Chinese assets in the U.S., routine financial, commercial, maritime, and aviation treaties are not practical for fear of impoundment of property within the borders of the two nations. President Carter in 1977 publicly spoke of the fear of impoundment suggesting that if a Chinese ship attempted to dock at a U.S. port to load grain shipments, the vessel could be impounded by an American citizen claiming China owed him reimbursement for seized property in Peking.[20]

In 1973 Secretary of State William Rogers and Chi Peng-fei, then Chinese foreign minister, agreed upon terms of settlement of the assets, yet no action followed. Early in March 1979, Treasury Secretary Blumenthal, while in Peking, reached a new agreement which settles the $197 million in U.S. claims outstanding in Peking at a rate of $.41 on the dollar. The total amount the Chinese will pay is $80.5 million, with $30 million due on October 1, 1979. The remainder of the Chinese obligation is expected by 1984.

Resolution of the frozen assets question, a problem which had been called a major obstacle to normal trade relations, does not in itself guarantee "smooth sailing." As Secretary Blumenthal commented after the announcement of the settlement, numerous visits back and forth to Peking are still ahead of him.

EXPORT-IMPORT BANK

The U.S. Export-Import Bank activities with any Communist country (as defined in the Foreign Assistance Act of 1961) are curtailed by the Export Import Bank Amendments of 1974 (PL 93-646). These amendments restrict the Bank from extending any credit or guaranteeing any credits for purchase of goods by Communist nations unless the President determines such action to be "in the national interest." The President must make a separate determination for each transaction involving Bank credits of $50 million or more.

MFN STATUS

The most sensitive legislative barrier applicable to the PRC is contained in the Jackson-Vanik amendment of the Trade Act of 1974 (PL 93-618) regarding extension by the U.S. of MFN treatment to a foreign government. Pursuant to this law the President is

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20. Stephen Barber, "Breaking the Ice on Frozen Assets," <u>Far Eastern Economic Review</u>, October 27, 1978, p. 44.

forbidden from granting MFN status to any non-market economy which practices restrictive emigration policies unless he receives "assurances" from the government that steps have been taken to significantly improve the freedom of emigration. MFN status was originally restricted under the Trade Agreement Extension Act of 1951. Poland and Yugoslavia had acquired MFN status prior to the Trade Act of 1974 while Hungary and Romania have been granted waivers under the Jackson-Vanik amendment. The Soviet Union, Czechoslovakia, Bulgaria, East Germany, Albania, and the PRC are currently among the countries excluded from this privilege.

Possible extension of MFN to the PRC has already evoked much congressional discussion. Senator Adlai Stevenson (D.-Ill.) recently introduced a bill, S 339, which would require the President, under the Trade Act of 1974 provisions, to make decisions of waiver on the actual practices of non-market economies in emigration policies, rather than on their "assurances," and would extend the waiver period from one to five years. This bill is only the first of many expected to redefine the implementation of the Jackson-Vanik amendment.

It is not clear what gains the U.S. will derive from extending MFN status to the PRC, as the nation's ability to finance its development efforts with exports past 1979 is doubtful. The emigration policies of the PRC are at best vague, regardless of Teng Hsiao-ping's offer to allow ten million Chinese to enter the U.S. immediately.

Most alarming is the position taken by the Carter Administration that the U.S. can extend MFN to the PRC only if MFN is granted simultaneously to the Soviet Union. Both countries have stated that emigration is an internal matter and they will not tolerate interference from the U.S. The fallacy of linking MFN to "playing the China card" rests with the possibility of the U.S. being coerced into abandoning the principles set forth in the Jackson-Vanik amendment for two special cases, the USSR and the PRC. If America weakens its enforcement of these principles without justification, either concrete evidence that emigration policies have improved in both countries or significant economic gains for the U.S., then once again the U.S. will have wasted a trump card.

AMERICA'S SHARE OF THE CHINA MARKET

In addition to all other complications surrounding the growth of U.S.-PRC trade, the U.S. must contend with major competition from Japan and Western Europe as it attempts to penetrate the "China market." In February 1978 the Chinese signed an eight-year, $20 billion bilateral trade agreement with Japan. Japan will export technology and capital goods to China in return for Chinese oil and coal. With this agreement Japan should remain China's number one trading partner through 1985. However, reports in early March 1979, indicated that the Chinese have suspended contracts with Japanese firms for industrial and plant equipment valued at up to $2.5 billion. Such an abrupt suspension of some of the largest and most important projects in the modernization program demonstrates great economic uncertainty in the Chinese economy. Whether this action was taken as a result of economic strains imposed by the Chinese conflict in Vietnam or rather because Chinese officials have recognized that purchase orders for imports exceed payment capabilities, makes little difference to the prospective businessman looking forward to ties in the PRC. The likely cancellation of previous orders signifies once more the fallacy of American aspirations for exploiting a "China market."

The suspension of Japanese contracts by the PRC also raises doubts concerning the Chinese fulfillment of numerous contracts signed with a host of foreign nations. The EEC signed its first agreement with China in April 1978 to establish a joint trade commision which will meet yearly. While no dollar specifications were included, the signatories agreed to expand bilateral trade under increasingly relaxed conditions leading to the extension of MFN treatment. A German engineering company, Lurgi Gesellschaft, recently beat Japanese and British firms in acquiring a $500 million contract to build three chemical plants in the PRC. Several U.S. companies will receive payment from the German company for licensing fees for processes used in the new plants. The U.S. Department of Commerce reports that the PRC has signed contracts with France, Kuwait, the Phillippines, Brazil, Canada, Egypt, Finland, Pakistan, and Bangladesh and trade protocols have been arranged with the Soviet Union and Eastern European nations.[21]

American companies have by no means been excluded from negotiating large contracts with the PRC. Some of the deals concluded to date include a $1 billion contract by U.S. Steel, a $100 million contract by Bethlehem Steel, a $1 million contract for tractors supplied by John Deere, and the purchase of a chain of establishments by Inter-Continental Corporation which could gross over $500 million. The Ford Motor Company has contracted to supply $3.5 million in trucks, Continental-Emsco, a Dallas-based corporation, signed a $40 million contract to supply oil rigs, and Boeing has sold three 747 jet airliners totaling $156 million to the PRC.

In light of the wide variety of capital commodities the PRC is purchasing, it appears appropriate to again question whether or not the government is attempting to modernize too quickly.

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21. Department of Commerce, op. cit., p. 11.

With the average industrial wage earner in the PRC taking home under $50 monthly, before subtracting the expenses of daily necessities, the purchasing of imported consumer goods will remain negligible once the novelty of Coca Cola has worn thin. As a state-operated economy, the PRC government still dictates either directly or indirectly what consumers may purchase.

Finally, there has been no tangible evidence to assume the Chinese are not still advocating the type of policy one official stated in a radio broadcast in 1974. Speaking on the PRC Daily Broadcast a PRC government official was quoted as saying:

> China uses foreign trade to stimulate production, scientific research, and internal trade....China imports certain new techniques and industrial equipment in line with the principle of "making foreign things serve China." This serves to reinforce the country's potentials of self-reliance and accelerate her socialistic construction.[22]

More recently, in July 1977, Teng Hsiao-ping, architect of the current PRC economic policies made some revealing statements before the Tenth CCPCC. Teng asked:

> Why can't we capitalize on contradictions and grudges between the U.S. and the USSR and adopt policies beneficial to us? We cannot be controlled by others; we have to control others. Excessive dependence on others will lead us into a passive position and prevent us from standing on our own feet. We will absolutely never do this. What we'll do is take chances to conditionally import what we need, especially the expertise and equipment in science and technology, which will benefit four modernizations the most. In the meantime, improving the China-U.S. relationship is an inexorable trend. The developing situation will certainly make the U.S. imperialists come to terms.

The "China Market" may indeed become a myth for American businessmen if statements by Huang Tsien-mo are to be believed. Huang, China's National Textile Import-Export Corporation said:

> Our capacity to export is limited, we don't expect our trade to grow that dramatically in the next few years... we must first meet the demands of the domestic market of 90 million people. The next priority is to export to places like Japan and South Korea where we have been selling for a longer time.[23]

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22. Foreign Broadcast Information Service, PRC Daily Broadcast, October 18, 1974, p. 241.

23. "Trade With China the Chinese Way: Tea and Empathy," Women's Wear Daily, February 15, 1979, p. 12.

The United States is currently the PRC's seventh largest trading partner, yet the two-way trade volume in 1978, $1.2 billion, was one-seventh the volume of U.S.-Taiwanese trade. Forecasts for future U.S.-PRC trade range from $2 billion in 1979, to $3 billion in 1981, and $8 billion by 1988. In striking contrast, the U.S.-Taiwanese trade should reach a two-way volume of $9 billion this year and the U.S. Department of Commerce estimates a $12 billion trade exchange for 1981.

In addition to these statistics Professor Chu-yuan Cheng of Ball State University, at a December conference on China sponsored by the Heritage Foundation, stated that due to the policy of self-reliance still practiced by the PRC, the U.S. cannot expect to ever capture over 20 percent of total Chinese trade. He also emphasized that U.S. trade with the PRC since 1972 has fluctuated tremendously according to the amount of grain imported by the PRC. In 1978 grains accounted for 70 percent of U.S. exports to China. Thus, a sudden expansion of industrial commodity exports from the U.S., as a result of normalization, is not likely unless extended on a credit basis and U.S.-PRC trade may continue on a sporadic basis.

While the chart below illustrates the competition the U.S. faces in engaging Chinese trade, one should also note that Great Britain, a nation which recognized Peking in 1950 is currently the PRC's tenth largest trading partner. One could convincingly argue that the British have not benefited greatly in economic terms from their normalization of relations with Peking. Relating this thought specifically to the U.S., Professor Cheng argues that although the U.S. has retained normal relations with the Soviet Union for 45 years, U.S. trade with the USSR in 1977 totaled less than 2 billion dollars, thus, "this may serve as an indication that the problem of normalization has little effect on international trade."

CHINA: TOP 10 TRADING PARTNERS

	Total Trade (Million US $)		Rank	
Country	1976	1977	1976	1977
Japan	3,052	3,509	1	1
Hong Kong	1,620	1,779	2	2
West Germany	952	826	3	3
Australia	380	631	7	4
Romania	451	600	5	5
Canada	309	459	9	6
United States	351	391	8	7
USSR	417	338	6	8
Singapore	295	324	10	9
United Kingdom	277	284	12	10

Source: CIA, "China: International Trade 1977-78."

THE JAPANESE FORMULA

In an attempt to mollify the critics of the President's China policy who are particularly concerned over the preservation of prosperous U.S.-Taiwanese trade, the so-called "Japanese formula" is being offered as an encouraging precedent for U.S. trade relations with both the PRC and Taiwan following "normalization." The basic premise of the "formula" states that Japan continued successful and increased trade with Taiwan and the PRC following recognition of Peking. Two problems arise here. First, the applicability of the Japanese experience to the U.S.-China trade prognosis is questionable in view of Japan's geographic proximity and cultural affinity to China. More importantly, however, after examining Japan's trade with both the PRC and Taiwan prior to her September 1972 recognition of Peking and immediately thereafter, no basis is found in the "formula" for encouraging predictions of a rapid growth in the U.S.-PRC trade volume.

During the decade preceeding Japan's severance of diplomatic relations with Taiwan, Sino-Japanese trade increased almost yearly. In 1962 the Japanese signed the "L-T Memorandum" which provided for an average two-way trade with the PRC of $100 million per year for five years, ending in 1967. Included in the exchange were Chinese exports of coal, iron, soybeans, and tin in exchange for Japanese agricultural machinery, steel, and industrial supplies. This agreement allowed deferment of Chinese payments for industrial commodities through financing by the Japanese Export-Import Bank. Japan's trade with Taiwan also grew during this period and for the two years prior to recognition of Peking, Japan's trade with Taiwan exceeded that with the PRC. Trade with Taiwan centered around Taiwan's quest for the latest available industrial equipment in order to satisfy her rapid economic growth and her historical background as a Japanese colony for 50 years..

Looking at the figures in the table below one notes that in 1973 Japan's trade with Taiwan was still larger than with the Mainland and in 1974, four years after "normalization," exports to Taiwan still exceeded exports to the PRC. Thus, Japanese trade with the PRC did not explode immediately upon according Peking diplomatic recognition.

JAPAN'S FOREIGN TRADE

(U.S. $ Millions)

Year	Taiwan		PRC	
	Exports	Imports	Exports	Imports
1962	107	58	39	46
1952	218	157	245	225
1970	700	251	569	254
1971	767	267	579	323
1973	1642	891	1039	974
1974	2009	955	1984	1305
1975	1822	812	2259	1531
1976	2452	1094	1746	1306
1977	2643	1120	2036	1473

Sources: Board of Foreign Trade, ROC; CIA, National Foreign Assessment Center; Ministry of Finance, Japan.

Other proponents of the Japanese model refer to the large growth in Japanese investments in Taiwan following normalization of relations with Peking. Japanese investment in Taiwan in 1972, the year of normalization, was a total of $7.7 million and grew to $45 million in 1973. These sums, however, are miniscule when compared to a U.S. direct business in Taiwan in 1978 of over $500 million.

The PRC openly conducts its economic policies as a function of political objectives and this is revealed in the relations between Japan, Taiwan, and the PRC. For example, Chou En-lai's "Four Conditions" for Sino-Japanese trade announced in 1970 included the qualification that the PRC would not trade with nations aiding or investing in Taiwan. By 1972 the majority of Japanese firms were complying with this regulation by either forfeiting relations on Taiwan or sacrificing their business ties in the PRC for more favorable relations on Taiwan. Japan's inability to cope with this type of economic restriction led one Asian scholar to conclude that the quest for further expansion of trade with the PRC contributed to Japan's decision to recognize Peking.[24] The "Four Conditions" were dropped with Japan's severance of diplomatic ties with Taiwan in 1972, but in that year Japan was already the PRC's largest trading partner.

Unlike Japan's recognition of Peking, the American recognition involved the abrogation of the U.S. Mutual Defense Treaty with Taiwan. This action raises even more doubts for positive U.S. trade relations with Taiwan over the next decade. David Nelson

24. Shao-Chuan Leng, "Sino-Japanese Trade," Law and Policy in International Business, Vol. 5, No. 3 (1973), pp. 780-803. Dr. Leng discusses the political ramifications of the PRC's economic ties with Taiwan prior to 1972.

Rowe astutely analyses the so-called "Japanese formula" in U.S. China Policy Today. He exposes the U.S. military security afforded both Taiwan and Japan as the crucial guarantor of Japan's successful economic relations with the PRC and Taiwan after 1972. He states, "Without such security guarantees and the practical military implementations thereof to both nations by the United States, the peaceful and uninterrupted continuance of their mutual relations would have been impossible."[25] The PRC was adamant in obtaining U.S. abrogation of the defense treaty as a condition for "normalization" of relations, yet this may lead to a PRC push for direct control over the Taiwanese economy. The U.S., in looking forward to trade relations with China patterned after the Japanese success, must proceed very cautiously to avoid simultaneously undermining the guarantee for continued prosperous trade with Taiwan. The U.S. may soon be forced to balance economic ties with Taiwan against the political wishes of the PRC, a consequence of recent U.S. foreign policy actions.

TAIWAN

The potential economic consequences of the Carter Administration's severance of diplomatic relations with Taiwan must not be neglected in view of the healthy economic relations the U.S. has enjoyed to date with Taiwan.

The U.S. Embassy in Taipei has reported an American direct investment of $27 million in Taiwan during 1978, a 69 percent increase over similiar investment in 1977. Cumulative totals through 1978 exhibit an estimated $2.8 billion extension of credits by American banks to Taiwan, an approximate $1.8 billion in loans or guarantees by the U.S. Export-Import Bank (Taiwan is currently the Bank's third largest customer), and direct American business investments exceeding $550 million. The Overseas Private Investment Corporation (OPIC) has a $140 million exposure in Taiwan.

Taiwan's per capita income in 1978 was four to five times larger than that of the Mainland. With a 1978 GNP of roughly $22 billion and reserve assets more than double those of the PRC, the prospects for continual long-range growth of U.S. trade with Taiwan appeared certain until the December 15th announcement.

U.S. exports to Taiwan totaled $2.3 billion in 1978, a 21.3 percent increase above 1977, while U.S. imports from Taiwan amounted to $5 billion.[26] With a two-way trade volume in 1978 slightly

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25. David Nelson Rowe, U.S. China Policy Today (Washington, D.C.: University Professors for Academic Order, 1979), p. 19.

26. Washington Post, January 11, 1979.

above $7.2 billion, Taiwan rose from America's eleventh largest trading partner in 1977 to the eighth largest in 1978. The projected two-way trade volume for 1979 is $9 billion. In contrast, U.S. exports to the PRC in 1978 totaled $823.6 million with imports totaling $324.1 million.[27] The PRC trade as a percentage of world trade has risen only .3 percent in eight years, from a 1970 percentage of .7 to 1 percent of total world trade in 1978.

U.S. TRADE (MILLIONS U.S. $)

	Taiwan		PRC	
	Exports	Imports	Exports	Imports
1970	363.9	565.7	0.0	0.0
1971	408.3	859.3	0.0	5.0
1972	543.4	1,251.3	63.5	32.4
1973	952.5	1,677.1	740.2	64.9
1974	1,679.9	2,036.6	819.1	114.7
1975	1,652.1	1,822.7	303.6	158.3
1976	1,797.6	3,038.7	135.4	201.9
1977	1,963.8	3,636.3	171.3	202.7
1978	2,380.0	5,000.0	823.6	324.1

In contrast to past PRC trade policies Taiwan has offered the U.S. and other foreign trading nations the advantages of a free enterprise system. Should the PRC suddenly impose strigent restrictions on Taiwan's freedom to conduct business as normal, the loss to the U.S. of the "existing asset of understanding" found in the business community on Taiwan may be larger than the immediate loss of returns on dollar investments on the island.[28]

On Taiwan a foreign investor may acquire 100 percent ownership of his business in addition to purchasing the land on which his facility is constructed. Freedom in marketing procedures and exporting extends further to employment practices, research and development, and patent rights. Foreign firms may bring in their own technology and in the three export processing zones may import duty free many of the required raw material inputs.

During 1978, Taiwan exhibited a valuable spirit of cooperation in attempting to alleviate her trade surplus with the U.S. Three missions during the year by Taiwanese officials culminated in

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27. Figures obtained from the Department of Commerce, Office of East-West Policy and Planning.

28. Thomas G. Corcoran, "Commerce and Politics in China Today" in Edwin J. Feulner, Jr., ed., China--The Turning Point (Washington, D.C.: Council on American Affairs, 1976). The "asset of understanding" included U.S. educated and western-oriented Chinese now conducting the commerce of Taiwan.

purchase contracts of over $1.5 billion of U.S. industrial, agricultural, and consumer goods with agreements on quotas and voluntary restraints upheld.

What does the PRC offer in return? Until recently most foreign commercial contact was limited to the biannual Canton Trade Fairs. The use of "middlemen" in the PRC to implement routine tasks related to business contacts has precluded the development of personal business contacts. The PRC does not permit foreign ownership of property or business establishments, although recent discussion within the government suggests foreign ownership of up to 49 percent may be tentatively agreed upon.

It has been suggested that Peking would benefit greatly from following the modernization policies of Taiwan rather than attempting to impose political restraints on Taiwan's economic freedom. Although the U.S. economy is not dependent on trade with Taiwan, the loss of such a cooperative trade partner would be felt. Proponents of the Administration's new China policy are quick to point out that a Chinese population approaching one billion offers far-reaching opportunities for trade development. Yet the Taiwanese economy as viewed above is currently more viable and open than that of the Mainland. The fundamental question yet unanswered is how far the PRC will be willing to go in sacrificing political/ideological commitments in developing a market economy to facilitate Western penetration.

CONCLUSION

"Normalization" of relations between the U.S. and Peking raises numerous economic questions, the most obvious concerning prospects for rapid trade expansion. The existing ideological/political doctrines of the PRC in conjunction with a slowly growing infrastructure casts serious doubts on the emergence of an open-market atmosphere in Peking in the foreseeable future.

The "China market myth" remains for American businessmen seeking entrance in the PRC market outside the realm of heavy industrial and technological equipment or agricultural commodities. Perhaps the real "myth" and the crux of many unresolved problems lies with how the PRC will finance its efforts of modernization. As illustrated in this paper, the PRC lacks adequate foreign reserves, accumulation of vast revenues from oil exportation is unlikely, and the PRC's few export commodities will face strong competition in world markets.

In the area of finance one must ponder several implications of China's development efforts. For instance, if the PRC should try to take Taiwan's membership in the IBRD, IMF, and/or Asian

Development Bank, what will happen to the worldwide distribution of financial assistance through these international financial institutions? How will the PRC reconcile the existence of two Chinese currencies, the Taiwan dollar and the Mainland's renminbi? What would happen if the PRC decided to open up the economy in order to facilitate acquisition of development credits, and in this process attempt to float its currency on world markets? What nations will be willing to shore up the currency and at what price?

Aside from the problems of finance, once again politics plays a major role in determining the trade policy of China vis-a-vis the Western world. It is not clear that the PRC will abandon the strategy of "politics in command," a slogan coined during the Cultural Revolution. American policymakers appear too eager to reject the scenario that the PRC will exploit the prosperous Taiwan economy for their own economic gain, and subsequently to hold Taiwan's commercial activities "hostage" in order to acquire additional Western credits.

While the lure of the "China market" will remain largely intangible for American businessmen, broader U.S. interests, commercial and political, would best be served by a policy stressing continued economic relations with the PRC which directly benefit the U.S. Only with a realistic assessment of the China market can the U.S. prevent overextension of credits to the PRC to create a market or endanger the substantial viable market in Taiwan.

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