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MFN TRADE STATUS AND THE P.R.C. **(H. CON. RES. 204 - S. CON. RES. 47)**

INTRODUCTION

On October 23, 1979, President Carter submitted to Congress the bilateral Agreement on Trade Relations signed with the People's Republic of China (PRC) July 7, 1979. Of particular importance is the accompanying Executive Order waiving the application of Sections 402 (A) and (B) of the Trade Act of 1974. Section 402, the Jackson-Vanik Amendment, prohibits the extension of Most-Favored-Nation (MFN) trade status to any non-market economy practicing discriminatory emigration policies. However, as provided in the Act, the President may waive this restriction if he reports to Congress that such a waiver will "substantially promote" the ideals of free emigration and that he has received "assurances" that the emigration policies of the country will in the future "lead substantially" toward free emigration. Having determined that the PRC has fulfilled these two conditions, the President sent the required waiver to Congress, necessitating action by both houses within sixty legislative days of its receipt.

The House Ways and Means Subcommittee on Trade held hearings November 1 and 2 on the extension of MFN status to the PRC, H.Con. Res. 204. The Senate Finance Subcommittee on International Trade conducted subsequent hearings on an identical bill, S. Con. Res. 47, on November 15. Both resolutions simply state "that the Congress approves the extension of nondiscriminatory treatment with respect to the products of the People's Republic of China transmitted by the President to the Congress on October 23, 1979." Cognizant of the anxiety expressed by Chinese officials over what they perceive as unwarranted U.S. delay in implementing the trade agreement, the Administration is urging Congress to expedite this measure. However, the technical argument concerning congressional access to information raised in the hearings may dissuade either House from voting on the waiver prior to the 1979 recess. An examination of the testimony given by Administration and public witnesses during these hearings provides a basis for defining the relevant political and economic points of support offered for MFN. An analysis of each is given below.

offer the world vastly exceeds the number recipient countries can economically afford to accept. Massive emigration does not automatically imply "free" emigration. China can fulfill any yearly numerical requirement the U.S. chooses as a standard without granting a single visa to a dissident, scientist, or any type of professional the country does not want to lose. A careful distinction must be made between the granting of a large number of visas and the ability for large numbers of ordinary citizens to successfully apply and exit the PRC.

The emigration question became a source of contention in both the House and Senate hearings because of a technicality. When asked on numerous occasions to submit the Chinese written "assurances" received by President Carter to the appropriate committees for inspection, Secretary Christopher asked that the confidentiality of such diplomatic exchanges be preserved. Reminded that the Soviet Union's reaction to the Jackson-Vanik Amendment, in light of the 1972 U.S.-USSR bilateral commercial treaty, was made public, Senate committee members charged the Administration was not conducting an evenhanded policy vis-a-vis the PRC and the Soviet Union. This issue over congressional access to the written "assurances" is not irrelevant, for the knowledge of actual Chinese emigration procedural changes constitutes the basis on which Congress must accept or reject the presidential waiver.

ECONOMIC QUESTIONS

U.S.-PRC Balance of Trade

Every Administration witness testifying on the potential U.S. economic benefits from granting MFN status to the PRC alluded to the existing favorable balance of trade between the U.S. and PRC. The National Council for U.S.-China Trade reports that the U.S. trade with China, from its resumption in June 1971, projected through 1979, has consisted of U.S. exports totaling \$4.5 billion while imports of Chinese goods amounted to \$1.6 billion. In 1978 U.S. imports from China totaled \$324 million, or 3.2 percent of total China exports for that year, while U.S. exports to the PRC totaled \$818 million, or 8.1 percent of total Chinese imports for 1978. Although U.S. exports to China increased in 1978, the \$1.1 billion total U.S.-PRC trade was minor in comparison to \$50 billion in trade with Canada, \$25.6 billion with Japan and \$7.46 billion with Taiwan.

The assumption inferred from the testimony is that this favorable U.S. trade balance with China will continue. Estimates from the Department of Commerce predict a two-way trade volume of \$5 billion by 1985 with other sources predicting even higher totals. Included in these predictions is the further assumption that the granting of MFN status will allow the Chinese to sell more exports and thus earn needed currency with which to purchase high technology goods from the U.S.

Analysis

It is probable that for the short run the U.S. will maintain a favorable trade balance with the PRC. This balance, however, continues to be favorable only in monetary terms, for the strategic importance of U.S. goods imported by China heavily outweighs the value of goods the U.S. purchases in return. For example, some of the leading 1979 U.S. imports from China include wearing apparel, cotton fabrics, fireworks, basketwork, antiques, feathers and down, licorice root and tea. In contrast the leading 1979 U.S. exports to the PRC include corn, cotton, wheat, soybeans, drilling equipment and mining machinery, pipes, trucks, and measuring instruments. The qualitative values of these two lists are not equal.

Examining the recent economic trends in China with special focus on the agricultural sector, there is some likelihood that Chinese imports of U.S. grains and foodstuffs will decline during the next decade. In 1978 grains accounted for approximately 64 percent of total Chinese imports from the United States, thus playing a major role in maintaining a favorable balance of trade. During the 1950's and 1960's China's investment in agriculture hovered around seven to seven and one-half percent of total investment. During the seventies investment in agriculture has doubled to nearly fourteen percent. Recent CIA estimates of Chinese economic growth forecast a four percent growth in agriculture over the next 10 years while the growth rate of population slows down to 1.5 percent. The ability of China to feed its population may be realized sooner than expected, thus eliminating the need for sizable grain imports.

The prospects for an increase in the trade volume between the U.S. and PRC rests with the financial capabilities of the PRC. The continual availability of credits will allow China, in the short-run, to purchase a greater amount of imports. However, as discussed below, the implications of long-term debt may cause what has traditionally been a fluctuating economic growth pattern to take a new dive down from a credit-inspired high growth rate.

The Financial Status of the PRC - Credits

Former Secretary of Commerce Juanita Kreps, testifying on China's financial situation stated, "Its credit rating is excellent, and it has some \$23 billion in undrawn credit lines available from Western government agencies and private agencies." While U.S. banks have established relatively small lines of credit, the PRC is currently prohibited from using official U.S. credits under the Jackson-Vanik Amendment. Vice President Mondale has informed the Chinese that once the PRC is granted MFN status the U.S. is prepared to arrange credit totaling \$2 billion over a five-year period through the Export-Import Bank, on a case-by-case basis.

Analysis

Repeated throughout the hearings as evidence of China's economic solvency is the fact that none of the \$23 billion in credits now available to China from official and private sources has been drawn upon. The answer given as to why China has not used the credits was always that they do not need them. One should not conclude from this that China is financially stable. Another analysis of the untouched credits, offered by several writers for the Far Eastern Economic Review, is that China is bargaining for better interest rates. Whether it is in the best interests of the U.S. and other nations to extend lower rates of interest is a separate issue, but it should be mentioned that U.S. financing through the Export-Import Bank at a rate of 7.5 to 8.5 percent over a 35-year period, for instance, with the inflation rate at 15 percent, involves a grant or gift factor of over 50 percent.

It is difficult to estimate correctly the total loan commitments the PRC currently holds against its \$2 to \$4 billion in reserves. In addition to the \$23 billion, there have been a large number of contracts made under the deferred payment scheme as well as compensatory arrangements, none of which are included as official debts. Further, the Chinese have persuaded many Western banks to make deposits in their branch banks in China, which is yet another type of disguised loan. Using the International Monetary Fund standards for borrowing, China should engage in no additional credit arrangements because of its current reserves vs. debts vs. export capabilities status.

Several months following the U.S. normalization of relations with the PRC, the Chinese began to slow down their search for international financial support. In fact, numerous contracts (those made primarily with Japan) were cancelled. This indicated by early spring Chinese officials' recognition of an over-extended economy or one on the verge of borrowing itself into bankruptcy. With officials gearing up for a possible \$3.5 billion deficit in 1979, the reserve assets of the PRC become increasingly negligible.

Prospects for Chinese Oil Exports

Much attention was focused during the hearings on the potential for Chinese oil exports. This was the one U.S. economic benefit from granting the PRC MFN status that was consistently, but vaguely, offered. Senator Jackson and Deputy Secretary of Commerce for East-West Trade Kempton Jenkins both estimated Chinese oil deposits (both on-shore and off) at 100 billion barrels. In the first quarter of 1979 oil became the leading commodity imported from China by the U.S. Between January and May the U.S. purchased \$29.5 million of Chinese crude oil through a virtual one-time deal made on the West coast. There has been no mention by the Administration of subsequent oil deals other than the involvement of U.S. oil companies in private investments in the South China Sea.

Analysis

There is no conclusive evidence to date upon which one can assert that the PRC will ever be a major oil exporter. The PRC did not achieve energy self-sufficiency until 1963 and in 1965 80 percent of its energy needs was still being met with coal supplies. Projections for China's future economic growth and energy needs appear to be well matched internally. Optimistic trade estimates are now being based on a projected 10 percent GNP growth rate during the next decade while energy supplies are currently growing at a rate of up to 10 percent. Allowing for domestic consumption, there will be little excess oil for export purposes. The alternative facing the Chinese is to revert back to large-scale utilization of coal. While coal is plentiful, much of China's industrial sector has been converted to oil, and the use of the poor grade coal may create a tremendous pollution problem which the Chinese cannot handle. Japan has contracted to purchase \$10 billion worth of coal and oil between 1978 and 1985, thus cornering most of the market of possible exports.

One problem which exists for the private oil companies engaged in exploration contracts in the South China Sea is the right to refine any oil that is discovered. Much of the area where the investments are concentrated is disputed territory. China and Vietnam are continuing to fight over many of the offshore islands and the USSR's support of Vietnam in these claims disputes make it questionable whether the U.S. should seek further involvement in the matter.

If vast sums of oil indeed are discovered in the PRC, allowing for large-scale exportation, the U.S. faces an internal dilemma. The northeastern U.S. is in need of oil supplies, not the west coast, where Chinese oil would normally be shipped. It will be an expensive process to transport oil all the way around the world, in addition to the extra refinery costs to rid the oil of its high wax content. One alternative suggested is that the Chinese sell oil to the Middle East and that the U.S. purchase more from these countries. Such a scheme, however, does little to change U.S. dependency on this region. Moreover, the suggestion that the mere presence of Chinese oil on the world market will help to break up the OPEC cartel and lower world market prices is not valid. The PRC has good relations with the OPEC nations and would do nothing to jeopardize their prices or profits.

Taiwan

Perhaps in an attempt to avoid political discussions, none of the Administration witnesses mentioned the side effects the granting of MFN status to the PRC may have on Taiwan. However, the scope of U.S. investments on Taiwan and the welfare of America's seventh largest trading partner must not be neglected. While the economy of Taiwan has not suffered dramatically since U.S. normalization of relations with the PRC in December 1978, the immediate extension of MFN treatment to the PRC leaves several internal

Chinese problems unsolved. For example, the U.S. has been unable to engage the PRC in a bilateral agreement to limit their textile exports to the U.S. As a result there have been several unilateral restrictions placed on various commodities. No mention has been made concerning Taiwan's textile trade. Taiwan is the second largest supplier of textiles to the U.S. after Hong Kong, and textiles constitute Taiwan's largest export commodity. As the textile industry in the PRC continues to expand, the U.S. must take steps to assure Taiwan that its textile exports, now subject to quotas, will not be entirely sacrificed to fulfill future trade agreements with the PRC.

Mention was made during the hearings of the unfavorable balance of trade the U.S. has with Taiwan in contrast to a favorable U.S. balance of trade with the PRC. When the advantages Taiwan offers foreign investors are added in (profit repatriation, property ownership, three export processing zones), U.S. trade with Taiwan cannot be termed unprofitable. Moreover, Taiwan has begun a "Buy American" campaign (during three 1978 missions, Taiwan signed contracts to purchase over \$1.6 billion of U.S. goods), and has blacklisted the import of a small number of commodities purchased from Japan. Although the quantities of these blacklisted goods are not yet significant, the alternative supplier is the U.S. Concern over the U.S. imbalance of trade with Taiwan might be partially remedied if the 1979 calendar year moratorium on U.S. arms sales to Taiwan is lifted and not repeated. As part of the U.S.-PRC normalization agreement no new presidential commitments of weapons are permitted. The cost of weapons in the "pipeline" for delivery as of January 1979 was estimated at \$720 million. This would be a welcome addition to the U.S. balance of payment. In general, failure to consider Taiwan in a cost/benefit analysis of extending MFN status to the PRC may result in long-range harmful consequences for U.S. business ventures on the island.

CONCLUSION

In order to implement the provisions of the bilateral trade agreement initialed by the U.S. and the PRC in July 1979, the Congress is now being asked to support a presidential waiver of the Jackson-Vanik Amendment. This would permit the U.S. under the provisions of the Trade Act of 1974 to grant MFN status to the PRC. The consequences of this MFN extension are now being considered on both political and economic merits, although the economic implications remain sufficiently vague so as to prevent any definitive analysis. This is a common hazard when dealing with non-market economies.

Most of the support given in favor of granting MFN status to China has been of a general nature. When asked the most obvious question concerning the monetary differences in tariffs the Chinese would pay on exports to the U.S. with and without MFN status, none of the Administration witnesses was able to supply

an immediate answer. The fact that almost half of the items the U.S. currently imports from China enter duty-free and that the types of imports will not drastically change minimizes the potential gains China can expect from the Column 1 nondiscriminatory tariffs and non-MFN Column 2 tariff duty differences. Based on 1978 figures from the Department of Commerce, the cut in duty rates would benefit significantly only Chinese textile exports, such as shirts and sheets. If a working bilateral textile agreement does not precede the granting of MFN status to China, the U.S. textile industry will face tougher competition than it currently experiences.

Should MFN be granted immediately to China, the PRC would indeed be the most-favored-nation in the U.S.-China bilateral arrangement. Although the U.S. currently maintains a favorable trade balance with the PRC, once MFN is accorded, Export-Import Bank credits will likely follow. The possibility of large scale future Chinese debt will negate the continuance of profitable trade for the U.S. Instead of attempting to facilitate improbable quantum leaps in U.S.-PRC trade through increased economic openings, the U.S. should safeguard its favorable economic ties in China, i.e., those with Taiwan.

If MFN is to be granted to the PRC there should be equal concessions given to the U.S. Guarantees for Taiwan's economic freedom and the U.S. right to sell arms to Taiwan must be understood as fundamental obligations the PRC fulfills in exchange for permanent MFN trade status from the U.S.

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