Asian Studies Center

Backgrounder

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THE BUSH ADMINISTRATION AND U.S.-CHINA TRADE

INTRODUCTION

While the centuries-old American dream of turning China's masses into consumers of American goods remains unfulfilled, few could have imagined a decade ago that United States commerce with the People's Republic of China (PRC) would be as significant as it is today. Overall, in fact, Sino-American ties, normalized only ten years ago, have matured despite a diplomatic history marked with confusion and contradiction. Since the end of World War II, the U.S. has "isolated" China, "contained" China, and played a "China card."

Two-way trade between the U.S. and the PRC is now estimated at $13.7 billion annually, with the PRC exporting half again as much to America as it imports. The PRC is the 13th largest U.S. trading partner. And the U.S., after Japan, is the second leading foreign market for Chinese products, especially textiles and clothing. American firms export mechanical and electrical products to the PRC, produce airplanes and automobiles in the PRC, and invest in the PRC in excess of $3 billion annually.[1]

Focusing on the Economy. While Beijing turned to the U.S. in the late 1970s for political and diplomatic help primarily to counter the Soviet threat, today it looks to America to help fuel its sweeping – and in many ways,

1 Robert Sullivan, "Doing Business in China," *Export Today*, March/April 1988, p. 17.

successful – modernization. The Chinese have come to view American dollars, technology, and know-how as the most visible evidence of U.S. support for China's reform efforts.

Last week, at the National People's Congress in Beijing, China's leaders announced new restrictions on the collectively and privately run Chinese businesses that have been the most dynamic sector of the Chinese economy. These restrictions could include a new 10 percent tax on private and collective enterprises, as well as on the business activities of military units and local governments. These steps could slow economic growth and make investments for American companies less attractive than in the past several years.

Demonstration by Example. Nonetheless, America's long-term economic interests in China will remain strong, as China becomes a more active participant in the world economic system. The expertise of American entrepreneurs in the PRC, moreover, can demonstrate to Beijing's leaders that the road to economic growth lies in loosening, rather than tightening, government restrictions on private economic activity.

Now that the Chinese seem to be restoring their political and economic ties with the Soviet Union, U.S.-PRC trade is a key element keeping the Beijing-Washington relationship strong. There also is room for the U.S.-China commercial and political relationship to grow. To spur it, George Bush should instruct his Administration aides to devise a coherent and sustainable economic policy that advances U.S. business interests in the PRC. Specifically, Bush should:

♦ ♦ Direct his new Ambassador to the PRC, James Lilley, to promote American business initiatives actively in the PRC. As a "Businessman's Ambassador," Lilley should host receptions and audiences at the embassy to assist prospective American business projects in China. Other nations routinely do this, to great effect. Current U.S. promotional efforts, like trade fairs and technology exhibits, should continue. Such exhibitions as last December's Plastic Equipment Exhibit in Guangzhou (Canton) are attended by large numbers of Chinese engineers and businessmen and provide many American firms broad firsthand exposure to the China market.

♦ ♦ Expand the commercial affairs sections of the U.S. embassy and consulates in China by increasing the number of Foreign Commercial Service (FCS) and Foreign Agricultural Service (FAS) officers and by strengthening, where possible, the data bases available to them and U.S. businessmen in the PRC. There are currently less than 20 FCS and FAS officers in China.

♦ ♦ Simplify U.S. policy on technology transfer to the PRC. Current U.S. policy is not at all clear as to which items, what degree of sophistication, and under what laws and circumstances technology may be transferred to China. A 1987 Office of Technology Assessment study proposes the creation of automated systems to accelerate, where possible, export licensing.[2] Congress should hold hearings to assess various means for reducing the complexity of U.S. policy regarding U.S. technology transfer to the PRC.

♦ ♦ Make clear to Beijing's leaders that recognition and enforcement of intellectual property rights is essential in creating the environment in which economic initiative thrives. Bush should urge Beijing to draft copyright legislation and, where necessary, improve the existing Chinese patent laws.

♦ ♦ Repeal those U.S. antitrust laws that impede American businesses in developing overseas markets, especially in economies, like the PRC, in which the central government plays a critical role.

♦ ♦ Urge Beijing's leaders to improve their country's foreign trading practices, eliminate their dual currency system, and enact price reform. Bush should set these as minimum requirements for U.S. support of PRC entrance into such important bodies as the General Agreement on Tariffs and Trade (GATT) and other International Economic Organizations (IEOs).

♦ ♦ Direct the Administrator of the U.S. Agency for International Development (AID) to maintain the Trade and Development Program (TDP) in the PRC but to study the possibility of transferring the program to private management. TDP finances "feasibility" studies to help U.S. firms get an edge in the Chinese marketplace. The program provides an important service for U.S. businesses, but it need not be financed by the U.S. government.

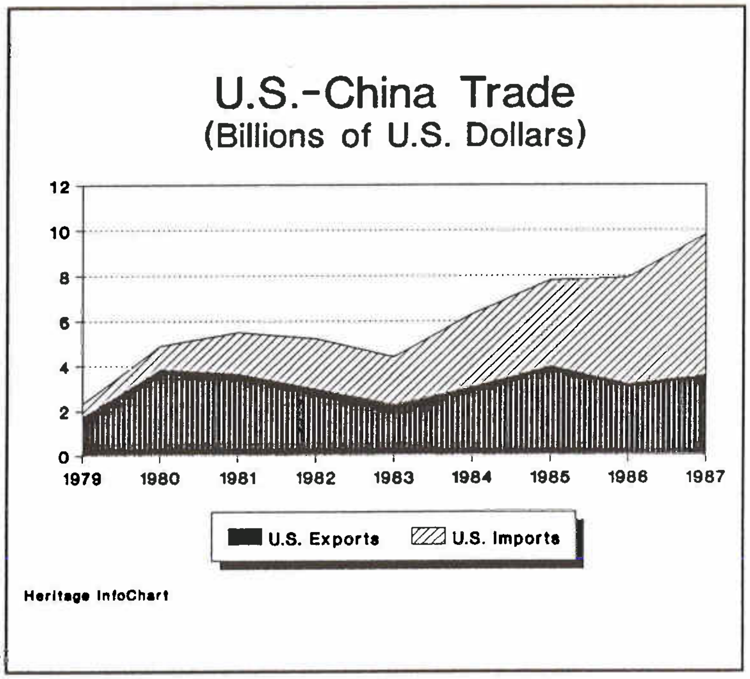
♦ ♦ Draft a Memorandum of Understanding (MoU) that summarizes American and Chinese positions regarding U.S. investment in the PRC and halt the negotiations for the Sino-American Bilateral Investment Treaty (BIT). U.S. negotiations for a BIT with China have been bogged down since their inception in 1983 and, at present, would not be ratified by the Senate. An MoU needs no Senate ratification and would reassure U.S. business interests in the PRC just as effectively.

♦ ♦ Request the Secretary of Commerce and the U.S. Trade Representative to examine the feasibility of a limited U.S.-PRC Free Trade Area (FTA) to be confined to the PRC's open coastal regions, particularly Guangdong and Fujian Provinces in the south and Liaoning Province in the north. The possibility of a limited U.S.-PRC FTA for Hong Kong after it passes to Chinese control in 1997 also should be considered.

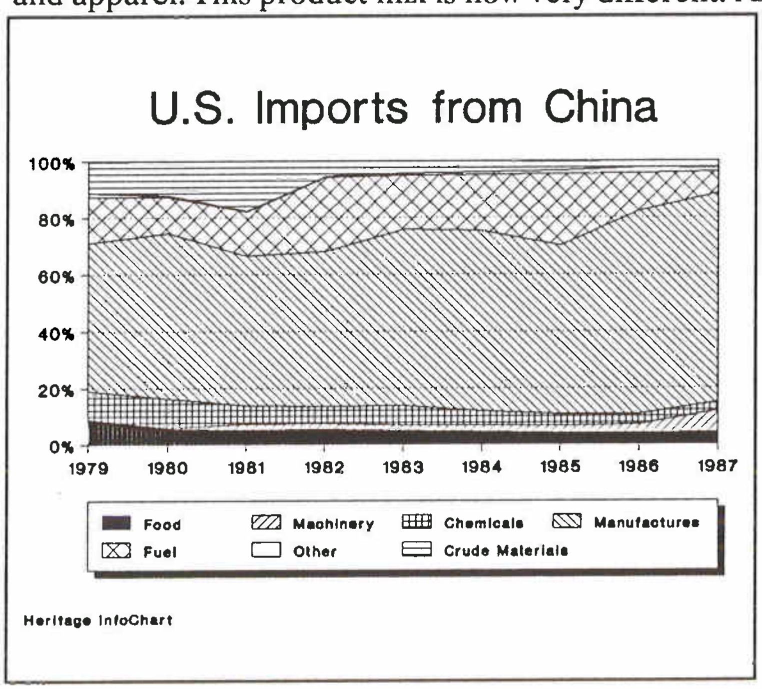
2 U.S. Congress, Office of Technology Assessment, *Technology Transfer to China*, OTA-ISC-340 (Washington, D.C.: U.S. Government Printing Office, July 1987).

THE EXTENT OF ECONOMIC CONTACT

Total trade between the U.S. and China for 1988 reached $13.7 billion, a nearly 40 percent increase over the previous year. Total trade between the two countries was only $990 million a decade ago. Illustrating the growth in U.S. business interest in China was last June's U.S.-China Joint Session on Industry, Trade, and Economic Development held in Beijing, sponsored by a consortium of U.S. and Chinese business interests. It attracted representatives from 700 small and medium-sized American companies and officials from most every Chinese province.[3]



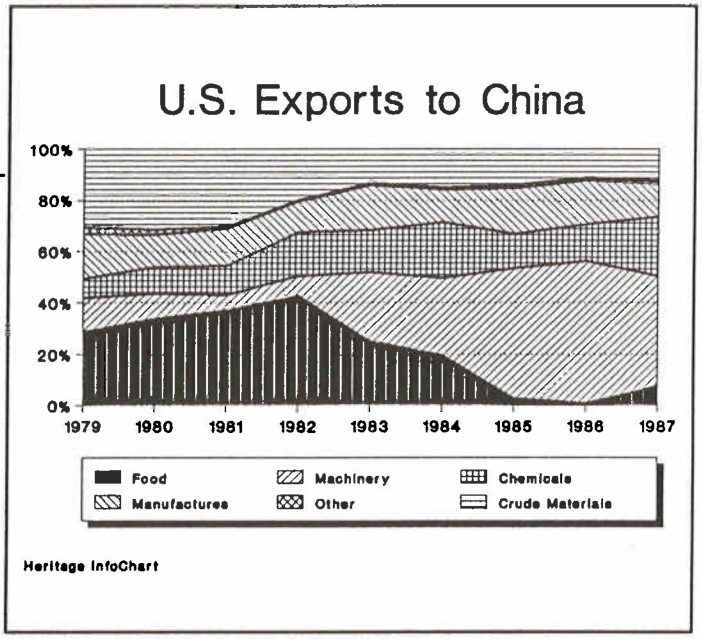
In 1972, the main products the U.S. sold the PRC were grain and cotton; in the same year, the U.S. imported just textile products, such as yarns, fabrics, and apparel. This product mix is now very different. American exports to China in 1987 were led by aircraft sales, measuring instruments, and computers. In 1987, American imports from China included TV sets, transistors, and graphic materials.



Prior to 1986, U.S. investment in China was dominated by joint ventures with Chinese government-owned enterprises in energy and real es-

3 *Beijing Review*, June 20-26, 1988, p. 21.

tate projects. But energy investment dropped because of the depression in world oil and coal prices, and real estate investment fell off because the Chinese decided to slow hotel construction to prevent a glut. Today, U.S. investment is more varied and concentrates in relatively small joint ventures in manufacturing. By the end of 1987, there were 407 U.S.-Chinese joint ventures, totaling $3.1 billion in investment.[4]



Current U.S. government estimates indicate that U.S. exports to the PRC increased over 50 percent in 1988, to top $5.3 billion[5]. There are also signs that American exporters of basic industrial materials, such as organic chemicals and paper board, expanded their business as the Chinese concentrated their reform efforts in the industrial economy. Moreover, U.S. exporters of agricultural products, especially wheat and corn, should do well in the PRC because summer droughts yielded poor Chinese grain harvests.

DOING BUSINESS IN CHINA

American companies have flocked to China since economic reform got underway ten years ago. In Beijing alone, there are more than 200 major American companies doing business. By most estimates, their results so far range from modest success to outright failure. Spurred by dreams of a billion customers, Americans have often set up shop for no other reason than to be in position to take advantage of China's vast potential market.

But the price of admission is high. Bureaucratic obstacles, legal tangles, and raw material shortages are just a few of the hurdles constantly confronting businessmen and are largely the reason why U.S. investment has not been more successful. Indeed, conducting business in China gets so complicated that foreign manufacturers who want to make their goods in China have little choice but to enter into joint ventures. A Chinese partner

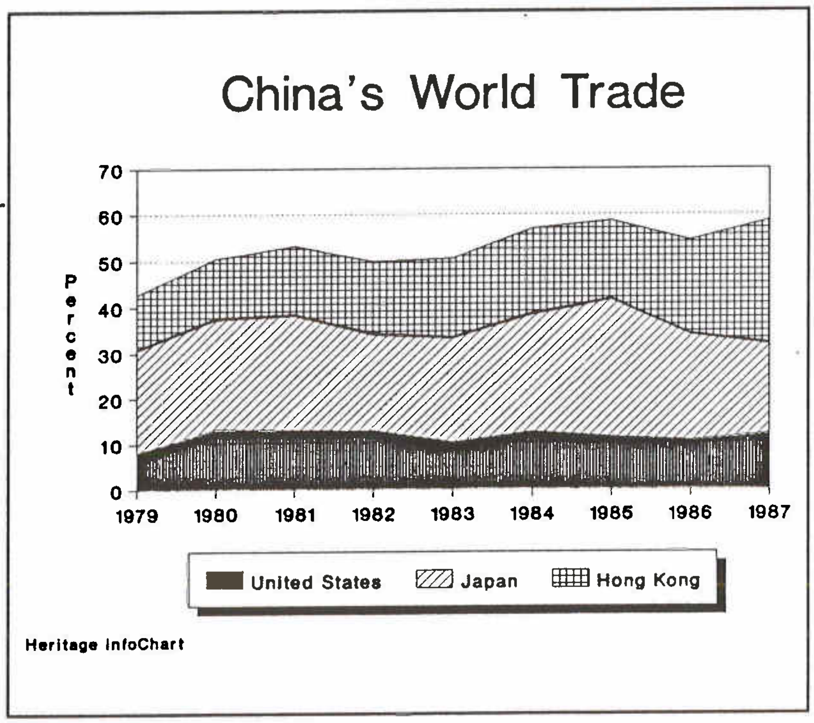
4 *Ibid.*

5 *Country Reports on Economic Policy and Trade Practices*, U.S. Department of State, Report Submitted to the Committee on Foreign Affairs, Committee on Ways and Means of the U.S. House of Representatives and the Committee on Foreign Relations and the Committee on Finance of the U.S. Senate, 101st Congress, 1st Session, March 1989, page 193.

has become indispensable to an American firm in supplying adequate raw materials and necessary contacts with the bureaucrats who control the supply of materials, labor, and other inputs essential to business success. Finding the right partner is by no means easy, especially for an American firm just starting up operations in the PRC. Says one Washington-based businessman of doing business in China: "It's like an endless mating dance."

Up until 1986, most foreign investment in China was in tourism, such as hotels, and in energy, which included exploration for China's offshore oil. In 1986, however, there was a decline in world oil prices. This decline meant the PRC suffered a reduction in one of its primary sources of hard currency. A Chinese splurge in industrial and consumer imports added to the PRC's hard currency drought. Subsequently, Beijing cut back on hotel construction and large industrial projects.

Although American investors are quick to point out that this has not discouraged them from investing in China, a new, more cautious pattern of investment has emerged since 1986. American investors now concentrate on small manufacturing projects, typically requiring less than $5 million. With a 30 percent inflation raging in China's cities, and Beijing's leaders, as indicated last week at the National People's Congress in Beijing, determined to slow China's reforms to reassert their control of the economy, American businessmen, uncertain of the direction of China's economy, probably will proceed even more cautiously during the next several years.



Nonetheless, two important factors indicate continued U.S. business interest in the PRC. Internationally, a principal U.S. competitor, Japan, is having problems conducting business in China. Japan's trade position in the PRC has greatly deteriorated in the past few years. The Japanese trade surplus with the PRC has convinced the Chinese that Japan is not doing enough to open its markets to Chinese imports. Also, the Chinese are dissatisfied with Japan's level of direct investment and technology transfer to the PRC, which lags far behind Hong Kong and the U.S. A weakened Japanese business position in China could mean improved business opportunities for Americans. As China gradually acquires the means to make more of its own products, its import needs will focus on more advanced goods and technology. U.S. companies, with their technological edge, are thus well positioned to continue as major suppliers to China's modernization effort.

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The Chinese complain that many barriers needlessly hinder U.S.-PRC trade. They claim, for example, that the transfer of U.S. technology to China is too tightly controlled. In addition, imports into the U.S. of some Chinese commodities, such as textiles, are restricted. The Chinese lament the lack of Beijing-Washington agreements to protect bilateral investment. And they point out that trade concessions granted by the U.S. to many developing countries under the terms of the Generalized System of Preferences (GSP) should be extended to the PRC.

U.S. businessmen, meanwhile, cite the many problems in doing business in the PRC. Making money in China has been difficult for most. While the volume of trade and investment has exceeded expectations, the China market has yet to prove lucrative for many. The costs of simply negotiating a business deal can require several trips to China and protracted discussions. Moreover, it is difficult to sell their products in the Chinese marketplace because administrative and market practices are riddled with regulations, taxes, tariffs, and assorted controls. To make matters worse, laws frequently change without public notification. Acknowledges one Chinese official to The Heritage Foundation: "I suppose it often could be viewed like a roller coaster ride."

Many Advantages. Still, China offers America a seemingly endless commercial market, as well as a variety of affordable commodities. Trade also improves cultural contacts between the U.S. and the PRC. Perhaps most significant, U.S. commercial relations with the PRC reaffirm American support for Beijing's modernization efforts and serves as a reminder to the Chinese of the routine and cordial nature of the U.S.-PRC relationship.

For the PRC, American technology, skilled manpower, and capital are considered integral to the country's economic growth. Today, there are more than 3,000 Americans studying and conducting business in China.

The Bush Administration can strengthen the U.S.-PRC commercial relationship by adopting policies to help create a better environment for U.S. business interests in China. Specifically, the Bush Administration should:

♦ ♦ Direct the U.S. Embassy in Beijing actively to promote American business interests in China. Because *guanxi*, or "connections," are so important in the PRC, the U.S. business community would benefit from a public diplomacy campaign, which, as one businessman told The Heritage Foundation, would "drape the American flag" on prospective American commercial interests. The Embassy should work with the U.S. business community to identify influential Chinese government officials and businessmen, particularly those who will decide a project's future, and to educate them about prospective U.S. business projects. Useful in this regard would be inviting them to receptions at the embassy and audiences with the ambassador.

The U.S. should continue the successful trade fairs and trade missions sponsored by the Department of Commerce (DOC). The DOC's International Trade Administration (ITA) has been particularly successful in sponsoring trade shows through its Trade Fair Certification Program. Industry-organized Government Approved (IOGA) Trade Missions, organized by private businesses with the support of ITA, also have been integral in bringing many U.S. and Chinese businessmen together.

♦ ♦ Expand the commercial affairs sections of the U.S. embassy and consulates in the PRC by increasing the number of Foreign Commercial Service (FCS) and Foreign Agricultural Service (FAS) officers. Of the approximately 175 U.S. government employees presently working in China, fewer than 20 are FSCs or FASs. Assigned to the U.S. Embassy from the Departments of Commerce and Agriculture, respectively, the FSCs and FASs help U.S. businesses locate buyers, assist with contract negotiations, and help resolve contract disputes. More of them should be assigned to work in China.

♦ ♦ Review export controls on technology. The current U.S. controls on exports to the PRC lack clearly defined guidelines and adversely affect competitive U.S. industries, especially those dealing in computers, precision instruments, and advanced manufacturing equipment. Moreover, possible transactions are too frequently strangled in bureaucratic red tape. To be sure, security considerations are very important, and the U.S. government should ensure that controls prevent the transfer of certain technologies associated with electronic warfare or delivery systems. The Bush Administration should order an interagency review, involving the Departments of Commerce, Defense, and State, to find ways to improve the efficiency of the technology evaluation process. The current process often is bogged down by delays, which sometimes mean lost business opportunities for American entrepreneurs and corporations. To avoid these delays, the U.S. should better define the respective roles of each of the important U.S. agencies. A 1987 Office of Technology Assessment (OTA) report on technology transfer to the PRC should be reexamined by the Senate and House Committees that commissioned it. Specifically, the House Committee on Energy and Commerce and the Senate Committee on Banking, Housing, and Urban Affairs should assess the progress in technology transfer to the PRC since the OTA's report was released.

♦ ♦ Make clear to the Chinese that they will be unable to attract high technology if they do not safeguard intellectual property, especially pharmaceutical and chemical products and computer software. Washington should offer to help Beijing in the drafting of its first copyright legislation.[6] The U.S. should make clear American problems with China's existing patent law. China's leaders have indicated that the law will be amended this year. Patent life in the PRC is only 15 years instead of the international norm of 20 years; this is not long enough for American firms to recoup the investments they have made to develop particular technologies. There also is no product protection for chemicals in the PRC.

◆ ◆ Revise U.S. antitrust statutes that impede U.S. businesses from competing in overseas markets, like China's. The antitrust laws that are intended to limit unfair collusion by U.S. businesses in the American market often penalize and handicap U.S. business in China and elsewhere overseas. American firms will not cooperate or consult with one another to develop market strategies in the PRC, such as those that would lead to joint ventures among American firms to produce goods in China, because they fear an antitrust challenge by competitors. Current U.S. antitrust legislation, moreover, prevents specific industry associations from gathering cost, productivity, and similar information about markets in China.

Congress should consider amending antitrust laws to correct this situation. Specifically, Congress should 1) allow the Commerce and Justice Departments to grant a certificate to any joint American production venture in China which, after careful analysis, was not determined to threaten competition'[7] 2) revise the National Cooperative Research Act of 1984 to allow American businesses to enter into a joint research ventures without fear of antitrust action; and 3) allow industry associations to gather cost, productivity, and similar information on markets in the PRC and share this information with their association members.

◆ ◆ Determine specific criteria that Beijing would have to fulfill to gain U.S. support for its entrance into international economic organizations such as the General Agreement on Tariffs and Trade (GATT), to which it has been an observer since 1982. The U.S. government correctly has insisted that the current members of the GATT carefully evaluate China's application to enter the GATT, ever since Beijing launched its formal membership bid in February 1987. The U.S. should continue to state that PRC entrance is contingent on:

- Reform of the PRC's pricing system. GATT members have pricing systems that are based on the free market principles of supply and demand. Prices in the PRC are set by the government and often operate within a two-tier pricing framework, which distorts the flow of goods and provides incentives for corruption.

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6 The PRC has worked through almost 20 drafts of copyright laws in the last ten years. An official law is expected sometime this year. See Gao Hang, "China's Forthcoming Copyright Law," *The China Business Review*, July-August 1988, p. 53.

7 See Richard Thornburgh, "Grant Antitrust Exemptions," *The Wall Street Journal*, December 27, 1988.

- Improvement of practices that govern the activities of foreign businesses in China. Currently, American businesses have trouble selling their goods in the Chinese marketplace because it is riddled with ambiguous laws and regulations.
- PRC commitment to the tenets that govern the international economic community. In the past, the PRC has sought to blackball Taipei's entrance into international economic organizations. The U.S. should declare that international economic organizations must include all appropriate members and that the PRC's efforts to block Taipei's membership run counter to U.S. interests.
- Establishment of a unitary rate of exchange for investors and efforts to eliminate the discrepancies between official and unofficial exchange rates. American businessmen in China who seek to bring Chinese products to the U.S. can be offered as much as 8 yuan to the dollar by a Chinese exporter only to discover later that the foreign trade corporations with whom the American businessman must sign the final contracts for the products offers only one or two yuan to the dollar. The average official exchange rate has been fixed at 3.71 yuan to the dollar since July, 1986, while the rate at local foreign exchange "swap markets" have ranged as high as 6.5 to the dollar.[8]

♦ ♦ Maintain the U.S. Agency for International Development's Trade and Development Program (TDP) but explore the possibility of transferring it to the private sector. Since 1984, the U.S. has given through TDP a total of almost $16 million to 46 projects in China to help U.S. firms get in on the ground floor of prospective Chinese business projects[9]. Although TDP has provided support at important early stages for many U.S. projects in China, it is not the appropriate role of the U.S. government to finance U.S. business initiatives in the PRC. TDP should be privatized.

♦ ♦ Draft a Memorandum of Understanding (MoU) between the U.S. and PRC that summarizes the protection China is prepared to grant U.S. business investment in the PRC and assures that most favored nation status would apply to U.S. businesses. This would replace the Bilateral Investment Treaty (BIT) negotiations, which have been stalled since their inception in 1983. Washington and Beijing, moreover, have very divergent and presently irreconcilable views of a BIT. Each demands of the other unacceptable concessions. Chances are, moreover, that a BIT would not be approved by the U.S. Senate without the addition of riders concerning human rights and similar issues. An MoU would be an executive agreement that would reassure U.S. business interest in the PRC and reaffirm the importance Washington attaches to China's economic reform efforts.

8 State Department, *op. cit.*, p. 186.
9 David Richter, "The Foreign Role in Major Projects," *The China Business Review*, May-June 1988, p. 28.

♦ ♦ Appoint a commission to examine the feasibility of a limited U.S.-PRC Free Trade Area (FTA). In an FTA, trading partners agree to eliminate those restrictions, such as tariffs, that impede free trade. In particular, the commission should examine the possibility of a U.S. Free Trade Area with Hong Kong after it reverts to Beijing's control in 1997. A limited U.S.-PRC FTA covering Hong Kong would assure the economic freedoms of Hong Kong into the 21st Century and reassure American business that its investments would be protected. The FTA also could be extended to China's more advanced coastal regions such as Guangdong and Fujian Provinces. Another possibility would be a Northeastern FTA that could include Lioaning and Shandong Province and the Republic of Korea. The committee should establish the criteria upon which the U.S. might consider pursuing limited FTAs with the PRC.

CONCLUSION

The number of Chinese entities conducting foreign trade has risen from eight to over 1,000 in the 17 years since Richard Nixon's visit to China opened the door for U.S. businesses in the PRC. More than 200 American businesses have offices in Beijing and more than 50 in Shanghai. More than 3,000 Americans live in China, conducting business, studying, or teaching. More than 30,000 Chinese study in America, many of whom will take back to China American management techniques that will affect future Sino-American trade.

This business activity illustrates the growth of the Sino-American relationship, fully normalized just ten years ago. The emphasis in Beijing-Washington relations used to be confined to the strategic area, in which one side relied upon the other to counter the Soviet threat in Asia. Today, the relationship has economic and scientific dimensions.

The U.S. government should promote American commercial interests in China. It should examine and work to remove the obstacles to trade, especially the problems involving technology transfer and antitrust laws. It should ensure that American commercial interests are protected in the PRC, especially in areas where American intellectual property rights may be threatened.

Slow But Worthwhile. It will be a long time before China's one billion people all become consumers of American products. The pronouncements of Chinese leaders at last week's National People's Congress in Beijing that economic reforms will be slowed in the months ahead are not good news for American businesses considering investing and expanding investments in the PRC. Nevertheless, the Chinese market has attracted and deserves to attract the U.S. private sector.

It also is in the China market that U.S. trade competition with Japan may become most intense. It is there too that U.S. commercial ties could have profound influence, particularly in encouraging expanded economic reforms, greater political freedoms and respect for human rights, and a peaceful resolution of Beijing's difference with Taipei.

The past two decades have proved that the Yankee trader and investor once again can succeed in China. The Bush Administration now has the opportunity to press for changes, particularly in U.S. laws and regulations that could expand U.S-China commercial ties in ways benefiting both countries.

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