

Northwestern Journal of International Law & Business

Volume 3
Issue 1 *Spring*

Spring 1981

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Recommended Citation

J. Mishell George, Damian T. Gullo, Daniel D. Stein, Trade with the People's Republic of China: Current Status and Future Prospects, 3 Nw. J. Int'l L. & Bus. 21 (1981)

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Trade With the People's Republic of China: Current Status and Future Prospects

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Since the normalization of diplomatic relations with the People's Republic of China (PRC) in 1979,¹ U.S. trade with China has developed rapidly. In particular, 1980 saw significant developments in the institutional framework of U.S.-China trade relations, with the signing of several new trade-related bilateral agreements and a number of high-level visits in both directions.² At the same time, China has begun to update its domestic legal system as it plans to integrate more fully into the international economic order.³ The last year has also witnessed the cancellation of certain large development projects, and delay in the implementation of others,⁴ as the Chinese readjust their economic plans and priorities.

This Perspective will first discuss the current status of U.S.-China

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¹ This decision was announced on Dec. 15, 1978. See *The Joint Communique on the Establishment of Diplomatic Relations between the United States of America and the People's Republic of China*, 18 INT'L LEG. MAT. 274 (1979).

² See generally 81 DEP'T STATE BULL. No. 2047, at 33 (1981).

³ In 1980, China joined both the International Monetary Fund and the World Bank. See EAST ASIAN EXECUTIVE REPORTS, May 15, 1980, at 7.

⁴ See, e.g., BUSINESS WEEK, Mar. 9, 1981, at 38.

trade relations, with an emphasis on the developments of 1980. It will then present our view of the Chinese economy and prospects for the future development of China's foreign trade. Changes in the Chinese legal system will be mentioned only briefly, as those matters are treated in detail elsewhere in this issue.⁵

THE NEW FRAMEWORK FOR U.S.-CHINA TRADE

U.S.-China trade relations,⁶ which had been frozen since 1950,⁷ began to develop again in the early 1970's with the Nixon Administration's opening to China.⁸ Thereafter and through the 1970's, trade was erratic as grain shipments, a principal component of U.S.-China trade, varied considerably from year-to-year.⁹ The real breakthrough in trade was linked to the Carter Administration's decision to establish full diplomatic relations with the PRC effective January 1, 1979.¹⁰

The establishment of full diplomatic relations was quickly followed in 1979 by an agreement settling the dispute involving private U.S. claims against China and frozen Chinese assets in the United States,¹¹ and a bilateral trade agreement (Trade Agreement).¹² By the end of 1980, trade relations had become normalized, with the entry into force of the Trade Agreement as well as the signature of several additional agreements.

⁵ Alford & Birenbaum, *Ventures in the China Trade: An Analysis of China's Emerging Legal Framework for the Regulation of Foreign Investment*, 3 NW. J. INT'L L. & BUS. 56 (1981).

⁶ This section focuses on bilateral agreements that are directly trade-related. Other agreements, such as science and technology agreements, may also have some commercial fall-out. See Surrey & Soble, *United States Law and Treaties Affecting China Trade in A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA* 41 (Practicing Law Institute 1979) [hereinafter referred to as A NEW LOOK].

⁷ For a discussion of the U.S. embargo on trade with China, see Garson, *The American Trade Embargo Against China*, in CHINA TRADE PROSPECTS AND U.S. POLICY I (A. Eckstein ed. 1971); Lee & McCobb, *United States Trade Embargo on China, 1949-1970: Legal Status and Future Prospects*, 4 N.Y.U.J. INT'L L. POL'Y 1 (1971).

⁸ See Denny & Stein, *Recent Developments in Trade Between the U.S. and the P.R.C.: A Legal and Economic Perspective*, 38 L. & CONTEMP. PROB. 260 (1973).

⁹ In 1976, for example, two-way trade was only 337 million dollars, with China purchasing virtually no agricultural commodities from the U.S. Just two years later in 1978, however, trade turnover reached 1.1 billion dollars, as U.S. agricultural exports to China totalled 573 million dollars. See text accompanying notes 84-90 *infra*.

¹⁰ See 18 INT'L LEG. MAT. 274, note 1 *supra*.

¹¹ Agreement Concerning Settlement of Claims, United States-People's Republic of China, May 11, 1979, 30 U.S.T. 1957, T.I.A.S. No. 9306. For a detailed description of the agreement, see Lichtenstein, *The Claims Settlement Agreement Between the United States and the People's Republic of China*, 1 CHINA L. REP. 25 (1980).

¹² *Agreement on Trade Relations Between the United States of America and the People's Republic of China*, 18 INT'L LEG. MAT. 1041 (1979).

Recent Bilateral Agreements

The Trade Agreement, which entered into force on February 1, 1980, forms the backbone of the institutional framework for U.S.-China trade.¹³ The Agreement provides for: the reciprocal extension of non-discriminatory (most favored-nation) tariff treatment for imports from each country; protection of patents, copyrights and trademarks; procedures for the settlement of commercial disputes, including third country arbitration; and safeguards against market disruption. The Trade Agreement also addresses issues related to the facilitation of business activities, the establishment of business and government trade offices, and international financial, currency and banking transactions.

At the same time that the Trade Agreement was initialled in May 1979, a separate Trade Exhibitions Agreement was signed.¹⁴ The first official activities under this Agreement were the U.S. National Exhibition, held in Beijing (Peking) in November 1980,¹⁵ and a series of three Chinese exhibits in the United States in Autumn 1980.¹⁶

Four additional bilateral agreements, covering shipping, aviation, textiles, and consular matters, were signed on September 17, 1980, in Washington by President Carter and Chinese Vice Premier Bo Yibo.¹⁷ The first of these was a Maritime Agreement designed to increase commerce by opening major U.S. and Chinese commercial ports to calls by the other country's flag vessels and to afford to U.S. flag vessels the opportunity to participate equally and substantially in carrying sea cargoes between the U.S. and China.¹⁸

Under the terms of the Maritime Agreement, fifty-five U.S. ports were opened to PRC flag vessels.¹⁹ In return, U.S. vessels were granted access to all twenty Chinese ports that are open to international ocean shipping.²⁰ The objective that "a substantial share" of the trade between the two nations will be carried by each country's merchant marine is defined as meaning that national flag vessels of each nation will have the opportunity to carry not less than one-third of all cargoes

¹³ For a more detailed description of the Trade Agreement, see Jenkins, *Implications of Recent Agreements for United States-China Trade*, 14 INT'L LAW. 5, 9 (1980).

¹⁴ *Id.* at 12.

¹⁵ See BUSINESS AMERICA, Aug. 11, 1980, at 11; *id.* Nov. 17, 1980, at 3.

¹⁶ BUSINESS AMERICA, Aug. 11, 1980, at 13.

¹⁷ See *U.S.-China Agreements*, 80 DEP'T STATE BULL. No. 2044, at 1 (1980).

¹⁸ *Agreement on Maritime Transport Between the United States of America and the People's Republic of China*, 80 DEP'T STATE BULL. No. 2044, at 15 (1980).

¹⁹ *Id.* at 16-17.

²⁰ *Id.*

moving by sea between the U.S. and China.²¹ The Maritime Agreement should contribute to U.S.-China trade by expediting the direct shipment of goods between the two countries.

At the same time, business travel to China should be made easier as a result of a new Aviation Agreement²² that permits regularly scheduled airline links between the two countries. It allows each side to designate two official carriers. At this time, China has only one national airline, the Civil Aviation Administration of China (CAAC); the first U.S. carrier to China is Pan American World Airways (Pan Am), as designated in October 1980 by the Civil Aeronautics Board.²³ The second U.S. carrier, as yet undesignated, will be allowed to commence operations in about two years. Pan Am and CAAC each began U.S.-China airline service in January 1981.²⁴

The third agreement, signed in September 1980, sets limits on certain Chinese textile exports to the United States.²⁵ Because textiles are a particularly import-sensitive sector of the U.S. economy, and in view of the concern U.S. textile manufacturers have expressed about growing Chinese imports over the past several years, this is an important agreement.²⁶

A fourth agreement, on consular matters,²⁷ increases from two to five the number of consulates that each country may maintain in the other country.²⁸ The agreement also establishes standards for the treatment of U.S. and Chinese citizens in each other's country.²⁹

The last U.S.-China agreement, signed in 1980, was a Grain Agreement announced on October 21, 1980.³⁰ The Agreement calls for minimum purchases by the PRC of 6 million tons per year of wheat

²¹ *Id.* at 15.

²² *Agreement Between the United States of America and the People's Republic of China Relating to Civil Air Transport*, 80 DEP'T STATE BULL. No. 2044, at 15 (1980).

²³ *See* Wall St. J., Oct. 20, 1980, at 18, col. 2.

²⁴ N.Y. Times, Jan. 8, 1981, at 16, col. 2.

²⁵ *Agreement Relating to Trade in Cotton, Wool, and Man-Made Fiber Textiles Between the United States of America and the People's Republic of China*, 80 DEP'T STATE BULL. No. 2044, at 12 (1980) [hereinafter cited as *Textile Agreement*].

²⁶ The Agreement, however, has not eliminated all bilateral problems in the textile trade. American manufacturers of particular textile products have continued to voice concern over Chinese exports to the U.S. *See* notes 110-11 and accompanying text *infra*.

²⁷ *Consular Convention Between the United States of America and the People's Republic of China*, 80 DEP'T STATE BULL. No. 2044, at 17 (1980) [hereinafter cited as *Consular Convention*].

²⁸ At present, the United States maintains consulates in Shanghai and Guangzhou, while PRC consulates are located in Houston and San Francisco. New U.S. consulates will be opened in Shenyang, Wuhan and Chengdu, while the Chinese plan to open consulates in New York City, Chicago and Seattle.

²⁹ *See Consular Convention, supra* note 27, at 21-27.

³⁰ 81 DEP'T STATE BULL. No. 2046, at 13 (1981).

and corn for the next four years. The Chinese are permitted to purchase up to 9 million tons per year without further approval, but purchases in excess of 9 million tons must be approved by the U.S. Government.³¹

Financing Developments

The PRC became eligible for Export-Import Bank (Eximbank) financing in April 1980 as a result of a Presidential Determination.³² Eximbank is now able to consider applications for loans to China on a case-by-case basis, and, in fact, has already issued three preliminary commitments for loans.³³ It is difficult to predict as of this writing the extent of the role that Eximbank financing will play in U.S.-China trade. The Chinese have suggested that they consider Eximbank interest rates too high.³⁴ More generally, the Reagan Administration has proposed reduced credit limits for the Eximbank,³⁵ which would restrict the availability of funds even if the Chinese decide to pursue Eximbank financing.

In a related area, on October 7, 1980, the Overseas Private Investment Corporation (OPIC) initialled an Investment Incentive Agreement with the China International Trust and Investment Corporation.³⁶ This will facilitate political risk insurance coverage by OPIC of U.S. investment in China, and, in view of the receptiveness of the Chinese to joint ventures,³⁷ the agreement is likely to be important to the development of long-term U.S.-China economic relations.

Export Controls

During a visit to the PRC in July 1981 by Secretary of State Haig, it was announced that the United States would be willing to consider

³¹ *Id.*

³² Presidential Determination of Apr. 2, 1980, 45 Fed. Reg. 26017 (1980).

³³ CHINA BUSINESS REVIEW, Mar.-Apr. 1981, at 4; Wall St. J., Feb. 4, 1981, at 29, col. 4.

³⁴ Eximbank's basic rate for direct loans to foreign buyers of U.S. goods is now 8.75 percent, higher than the rate charged by some of its competitors. THE EXPORT-IMPORT BANK: FINANCING FOR AMERICAN EXPORTS—SUPPORT FOR AMERICAN JOBS 27 (June 1980) (public relations pamphlet).

³⁵ See, e.g., *Ex-Im Aid to Export Goes Under the Knife*, BUSINESS WEEK, Feb. 23, 1981, at 34-35.

³⁶ See THE CHINA BUSINESS REVIEW, Nov.-Dec. 1980, at 42. The China International Trust and Investment Corporation is an organization established to promote and facilitate the establishment of joint ventures in the PRC.

³⁷ See Alford & Birenbaum, note 5 *supra*.

the sale of arms to China on a case-by-case basis.³⁸ In addition, the U.S. now has adopted a more liberal export policy toward China with regard to dual-use and high technology items. Under the new policy there will be a presumption of approval for products with technical levels twice those previously approved.³⁹ The Commerce Department in April 1980 had placed China in a separate country category, thus removing it from the category containing the U.S.S.R. and certain other communist countries.⁴⁰ Then, in October 1980, revised licensing guidelines were issued that made it possible to export to China some goods and technology formerly prohibited such as dual-use items.⁴¹

The new policy announced in July 1981 also accords China preferential administrative treatment since all validated export licenses for China not requiring COCOM⁴² clearance will be processed by the Commerce Department.⁴³ By not requiring interagency review, which is needed for U.S. exports to the U.S.S.R. and certain other communist countries, the processing time for China cases should be reduced substantially.⁴⁴

CHINESE LEGAL DEVELOPMENTS

In the past two years, several important developments in the Chinese legal system have occurred that affect China's foreign trade. In order to understand their significance, one must examine these developments from an historical perspective. To the Western observer, especially the American attorney, what has been most striking about the Chinese legal system in the past has been the relative lack of legal institutions and legal codes.⁴⁵ Most commentators trace the current status of law in China to entrenched cultural attitudes. Law and legal institutions were viewed as coercive instruments⁴⁶ that in a society where close and continuing personal relations were unavoidable, provided an inferior method of control. Teaching by example and modification of social behavior through peer pressure were considered more effective

³⁸ Wash. Post, June 6, 1981, at 1, col. 3.

³⁹ Commerce Dep't Press Release, ITA 81-118, July 8, 1981.

⁴⁰ 45 Fed. Reg. 27922 (1980) (*amending* 15 C.F.R. § 368-399).

⁴¹ Commerce Dep't Press Release, ITA 80-155, Sept. 12, 1980.

⁴² COCOM is the acronym for Coordinating Committee, which consists of Japan and members of the North Atlantic Treaty Organization (NATO), except Iceland.

⁴³ Commerce Dep't Press Release, *supra* note 39.

⁴⁴ *Id.*

⁴⁵ See, e.g., Hsia, *Sources of Law in the People's Republic of China: Recent Developments*, 14 INT'L LAW. 25 (1980).

⁴⁶ See, e.g., Li, *Reflections on the Current Drive Toward Greater Legalization in China*, in A NEW LOOK, *supra* note 6, at 84.

and harmonious approaches.⁴⁷

A formal legal system began to develop in China after the Communists came to power but foundered in the late 1950's and came to an end with the Cultural Revolution.⁴⁸ The current drive toward greater legalism in China, which began in earnest after the fall of the "Gang-of-Four" in late 1976,⁴⁹ has resulted in a new constitution (revising a 1975 version)⁵⁰ as well as several new codes, dealing with *inter alia*, criminal law, governmental structure,⁵¹ and economic and financial matters. Concurrently, the Ministry of Justice, which had been abolished in 1959, has been reestablished⁵² and the Procuracy reconstituted.⁵³ Also, the role of lawyers in Chinese society has been legitimized by a new regulation governing their conduct.⁵⁴

The new legal provisions that are probably of most interest to American attorneys and businessmen are found in the joint venture law of July 1979, two tax laws covering joint ventures and individuals and their implementing regulations—Regulations on Labor Management in Joint Ventures, Regulations on the Registration of Joint Ventures—and new regulations on foreign exchange control. All of these matters are treated in detail in another article in this issue.⁵⁵

⁴⁷ If law as an institution was out of favor in ancient China, lawyers were even less beloved, being known commonly as "litigation tricksters". Li, *supra* note 46, at 87. A short quotation from an imperial decree of 1820 makes the point in rather blunt language:

The multiplication of lawsuits among the people brings much harm, and the machinations of the litigation tricksters are what produce all the inconsequential verbiage going helter-skelter into these accusations. These rascally fellows entrap people for the sake of profit. They fabricate empty words and heap up false charges. At their bidding, plaintiffs are induced to bring up stupid nonsense in their accusations whose empty falsity, when exposed at the trial, brings blame upon the plaintiffs themselves while the litigation tricksters stand to one side. . . .

No one knows how many lives have thus been damaged or brought to an end at the same time that the tricksters look on from the side and chirp their satisfaction. All these devilish doings certainly deserve our bitter detestation.

D. BODDE & C. MORRIS, *LAW IN IMPERIAL CHINA* 416 (1967).

⁴⁸ See Hsia, *supra* note 45, at 28; Li, *supra* note 46, at 88-92.

⁴⁹ See Li, *supra* note 46, at 93.

⁵⁰ See Cohen, *China's Changing Constitution*, 1 *Nw. J. INT'L L. & BUS.* 57 (1979).

⁵¹ These are discussed in Cohen, *The Year of the Law*, in *A NEW LOOK*, *supra* note 6, at 141.

⁵² See Lubman, *The Development of China's Formal Legal System*, in *A NEW LOOK*, *supra* note 6, at 117.

⁵³ *Id.* at 119.

⁵⁴ For a discussion of the regulation, see Cohen, *China's New Lawyer's Law*, 66 *A.B.A.J.* 1533 (1980); Nethington, *Provisional Regulations on Lawyers Adopted*, *EAST ASIAN EXECUTIVE REP.*, Oct. 1980, at 5.

⁵⁵ See Alford & Birenbaum, note 5 *supra*.

CHINESE ECONOMIC DEVELOPMENT AND
FOREIGN TRADE PROSPECTS⁵⁶

Economic Development and the Road to Modernization

While basic structural economic problems have plagued the PRC for many years,⁵⁷ the ideological conflict between moderate and radical factions within the Chinese Communist Party, which may be traced back to the Cultural Revolution,⁵⁸ undoubtedly contributed to China's uneven economic performance in the 1970's. The struggle put economic issues in ideological terms and reduced Beijing's ability to deal with the country's economic problems, particularly during the mid-1970's. The radicals supported a policy of maximum self-reliance that included opposition to foreign loans, emphasis on domestic innovation and unwillingness to permit foreigners to participate in the development of China's natural resources.⁵⁹ The moderates, on the other hand, favored a more pragmatic approach.⁶⁰

Recognizing that reliance solely on the country's limited technical resources would extend indefinitely the modernization program and confine China to the ranks of second-class nations, the moderates supported massive imports of Western equipment and technology, including large-scale plants, so as to transform China as quickly as possible into a modern industrial state.⁶¹ They argued that with the establishment of a technology base a return to greater self-reliance would become a more practical possibility.⁶²

By the mid-1970's, at a time when the health and influence of Mao Zedong and Zhou Enlai was fading, the jockeying for political position became more pronounced.⁶³ At the same time, the gravity of the eco-

⁵⁶ *Editors' Note*: Many of the statistics in this section of the Perspective will not be footnoted. The authors have taken their information from in-house Commerce Department documents based on U.S. Census Bureau Reports and U.N. Foreign Trade Tapes. The information is not readily available in relevant form to the public—the Commerce documents are often only computer printouts—so this Perspective must, in this respect, be considered an original source. Those seeking more documentation should write to Mr. Stein at his office at Commerce.

⁵⁷ See Dernberger & Fasenfest, *China's Post-Mao Economic Future*, in 1 CHINESE ECONOMY POST-MAO, A COMPENDIUM OF PAPERS SUBMITTED TO THE JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES 11-16 (1978) [hereinafter cited as CHINESE ECONOMY POST-MAO].

⁵⁸ *Id.* at 3-4.

⁵⁹ For an elaboration of this position, see Eckstein, *The Chinese Development Model*, in 1 CHINESE ECONOMY POST-MAO, *supra* note 57, at 86.

⁶⁰ See Dernberger & Fasenfest, *supra* note 57, at 36-37.

⁶¹ See, e.g., Chen, *Economic Modernization in Post-Mao China: Policies, Problems, and Prospects*, in 1 CHINESE ECONOMY POST-MAO, *supra* note 57, at 192-93.

⁶² See Dernberger & Fasenfest, *supra* note 57, at 37.

⁶³ See Whitson, *The Political Dynamics of the People's Republic of China*, in 1 CHINESE ECONOMY POST-MAO, *supra* note 57, at 72-73.

conomic situation was becoming more apparent. Deterioration was most evident in industry, which for more than a quarter century had been the major source of China's economic growth.⁶⁴ Imbalances within the iron and steel sectors brought steel shortages, and declining growth in coal production was causing widespread and disruptive energy shortfalls.⁶⁵ Agriculture, which despite heavy dosages of investment since the mid-1960's remained a drag on the economy, suffered still further.⁶⁶ Meanwhile, urban labor began to demand, after two decades of sacrifice, that a greater share of output be slated for consumption,⁶⁷ at a time when investment needs were also great.

In January 1975, at the Fourth National People's Congress, Premier Zhou Enlai presented general guidelines for China's economic development over the next twenty-five years.⁶⁸ In his address, Zhou clearly placed pragmatism ahead of ideological beliefs, and called for a dedicated drive toward achieving by the year 2000 the four modernizations—agriculture, industry, national defense, and science and technology. The Fifth Five Year Plan (1976-80), which was to have been the spring board for the modernization drive, proved difficult to implement, because of renewed political turmoil, unfavorable weather conditions and the Tangshan earthquake in July 1976.⁶⁹

Toward the end of 1975 and the beginning of 1976, the radicals stepped up their attacks on the modernization faction led by Vice Premier Deng Xiaoping.⁷⁰ The death of Zhou Enlai in January 1976, and Mao Zedong's death later that year, added to the turmoil. One month after Mao's death, the new, more moderate government of Hua Guofeng arrested the radical leaders, the Gang of Four, removing one of the primary sources of the disorder that had plagued China for the previous decade. This set the stage for a return to a pragmatic approach to the political and economic problems facing the country.

In February 1978, China unveiled an ambitious ten-year economic plan (1976-85)⁷¹ that incorporated the ill-fated 1976-80 five-year plan and marked a sharp departure from Beijing's past commercial dealings with the West. Because of the plan's heavy reliance on imports, partic-

⁶⁴ See Lardy, *Recent Chinese Economic Performance and Prospects for the Ten-Year Plan*, in 1 CHINESE ECONOMY POST-MAO, *supra* note 57, at 51.

⁶⁵ See Ashbrook, *China: Shift of Economic Gears in Mid-1970's*, in 1 CHINESE ECONOMY POST-MAO, *supra* note 57, at 217-18.

⁶⁶ See Lardy, *supra* note 64, at 51.

⁶⁷ *Id.* at 53.

⁶⁸ *Id.* at 48.

⁶⁹ *Id.* at 52-54.

⁷⁰ See Ashbrook, *supra* note 65, at 214.

⁷¹ Lardy, *supra* note 64, at 48.

ularly Western technology and equipment, China dropped ideological constraints regarding the use of foreign credits and began actively seeking joint ventures with the West.⁷² The new plan also gave more prominence to agriculture and light industry than in the past, but still continued to favor heavy industrial growth.⁷³ One hundred and twenty large-scale projects, which depended heavily on imports of Western machinery and technology, were scheduled to be completed or to be at least under way by 1985.⁷⁴ In addition, the 10 year plan set 1985 production targets for key commodities such as oil, coal, and steel.⁷⁵

The Chinese immediately began to negotiate and sign contracts with foreign companies for many of the large-scale projects included in the Ten Year Plan.⁷⁶ However, by December 1978, various factors, including sectoral imbalances, low productivity, and a shortage of hard currency, forced Beijing to shelve the 1976-85 plan in favor of an economic "readjustment" program that was originally scheduled to run for a three-year period through 1981.⁷⁷ As a first step toward solving the country's problems, economic priorities were reordered: investment for agriculture and light industry was increased at the expense of investments in heavy industry; a number of the 120 large scale projects were scaled down, postponed or cancelled; emphasis shifted towards the improvement of existing facilities, rather than complete "turnkey" plants; and production targets for oil, coal and steel were deferred for at least another five years.⁷⁸ Those sectors that had constrained China's economic growth—energy, transport, and building materials industries—nonetheless were assigned to receive high priority.⁷⁹ At the same time, Beijing took steps toward economic reform by giving state enterprises and local governments greater decision-making authority and implementing incentive measures.⁸⁰

The retrenchment period now is expected to last until the mid-

⁷² See Gullo, *Prospects for China Trade Through 1985*, BUSINESS AMERICA, Aug. 11, 1980, at 3.

⁷³ *Id.* Agriculture and light industry in 1978, for example, accounted for only 11 and 5 per cent, respectively, of state budget-financed investment spending, compared with an allocation of 55 per cent for heavy industry. *Id.*

⁷⁴ Premier Hua Guofeng's Report to the Fifth National People's Congress, quoted in Chen, *supra* note 61, at 171.

⁷⁵ *Id.* These targets quickly proved to be unrealistic.

⁷⁶ See, e.g., THE CHINA BUSINESS REVIEW, Nov.-Dec. 1978, at 61.

⁷⁷ See *Doing Business with China*, U.S. Dep't of Commerce, INTERNATIONAL TRADE ADMINISTRATION, Nov. 1980, at 2.

⁷⁸ See Gullo, *supra* note 72, at 3-4.

⁷⁹ *Id.*

⁸⁰ See CENTRAL INTELLIGENCE AGENCY, CHINA: POST-MAO SEARCH FOR CIVILIAN INDUSTRIAL TECHNOLOGY 9 (1979).

1980's.⁸¹ China apparently has fallen behind in achieving even the relatively modest goals called for by its original three-year economic "re-adjustment" program, which has been hampered by shortfalls in the 1980 harvest, as well as stagnant oil and electrical power output. Furthermore, newly instituted economic reform measures have brought new problems while failing to come to grips with some old ones. For example, the central government's task of controlling an already overcommitted capital construction sector has been made difficult by the decentralization of economic authority. Overspending on construction coupled with rising wages resulted in state budget deficits the last three years (1978-80).⁸² As a result, China has chosen to conduct another round of cost cutting that affects both existing and new projects involving foreign firms.⁸³

Foreign Trade Objectives and Past Performance

Following the 1960's, a decade in which China's trade with the West stagnated at around \$3 billion a year, Beijing, as has been discussed, adopted a more outward looking economic policy that brought trade to a level of \$35.2 billion in 1980, more than ten times greater than that in 1970. The PRC, during the 1970's, looked to the West for metals (mainly steel), machinery and equipment, and advanced technology to support the growth and development of its industrial sector.⁸⁴ China also relied heavily on imports of Western agriculture commodities such as grain, cotton and sugar to help feed and clothe its huge population.⁸⁵ More recently, the government has sought imports that can be used in domestic projects designed to generate additional export earnings. In addition, in an effort to improve living standards, Beijing has increased its purchases of consumer goods. On the export side, sales to the West represent China's main source of the hard currency necessary to finance imports. Exports over the past decade have covered a wide range of goods from foodstuffs to manufactures.

The fluctuations in China's trade with the West during the 1970's, particularly on the import side,⁸⁶ reflect to some extent the political

⁸¹ FOREIGN BROADCAST INFORMATION SERVICE, Mar. 26, 1981 at U1.

⁸² The imbalance in 1979 reached a record \$11.4 billion, and the 1980 deficit totalled roughly \$8.0 billion, which was substantially higher than originally anticipated.

⁸³ THE CHINA BUSINESS REVIEW, Mar.-Apr. 1981, at 3.

⁸⁴ See generally Batsavage and Davie, *China's International Trade and Finance*, in CHINESE ECONOMY POST-MAO, *supra* note 57, at 711-32.

⁸⁵ *Id.*

⁸⁶ Imports in 1975 were trimmed as a reaction to a larger-than-anticipated 1974 trade deficit that was caused by rapidly increasing import prices, weakened demand for Chinese exports, and

turmoil that gripped the country, and Beijing's changing economic policies. The internal political struggles apparently had a lesser effect on China's exports.⁸⁷

Prior to the formal launching in 1978 of China's modernization drive, U.S.-China trade, consistent with the larger patterns of trade with the West, was characterized by erratic levels of U.S. exports and a slow but steady growth in U.S. imports. During the 1972-77 period, Beijing apparently treated the U.S. as a residual supplier of basic commodities, such as grain, cotton, soybeans, and aluminum; and bought from the U.S. only to cover pressing short-term needs. Purchases of U.S. technology, meanwhile, generally were confined to unique or clearly superior products. Now, however, Beijing apparently views the U.S. as a counter-weight to growing Soviet influence in Asia, and as an important source of agricultural and high technology items.

With the lifting of the U.S. trade embargo, commercial transactions between the two countries resumed in the early 1970's for the first time in two decades. The removal of restrictions came at an opportune time for Beijing, since China in 1973-74 needed grain, cotton, and soybeans, for which the U.S. was the only source available. These purchases, in addition to the delivery of ten Boeing 707 aircraft⁸⁸ pushed exports to the PRC sharply upward, to \$807 million in 1974. In 1975, however, as China turned to other suppliers for agricultural commodities, Chinese purchases of U.S. goods were slashed by nearly two-thirds, suffered a further cut in 1976, and registered only a small increase in 1977. But, in 1978, U.S. exports to China jumped four-fold, to \$818 million, because of renewed Chinese purchases of substantial amounts of U.S. grain and cotton. Interestingly, these purchases were made at a time when other suppliers could have filled at least part of China's order. An increase in sales of manufactures, particularly steel pipe and oil and gas equipment, also contributed to the surge in U.S. exports. U.S. imports also increased, with large purchases of manufac-

the need for additional quantities of imported grain and cotton. In 1976, imports fell sharply as the political turmoil reached a climax with the deaths of Mao and Zhou Enlai; the lack of agreement within the leadership on the new five-year plan and debate over trade policy held down purchases. Then, with the adoption of the ambitious ten-year economic plan in 1978, hard currency imports that year increased by nearly 60 percent.

⁸⁷ After increasing at a vigorous clip in the early 1970's, the growth of exports to the West declined sharply in 1975 and registered little gain in 1976. Nevertheless, the level of hard currency exports continued to increase during this tumultuous period. The volume of exports picked up again in 1977, and has continued to grow, so that in 1980, exports to the West reached roughly \$17.7 billion.

⁸⁸ See Avery and Clarke, *The Sino-American Commercial Relationship*, in CHINESE ECONOMY POST-MAO, *supra* note 57, at 744, 754.

tures, particularly cotton fabrics. These large increases reflected Chinese efforts under its modernization program to improve living standards and boost hard currency exports of textiles. In 1979 and 1980, U.S. trade with the PRC flourished,⁸⁹ aided by the diplomatic recognition of the People's Republic of China on January 1, 1979, and the signing of the several major bilateral agreements previously discussed.⁹⁰

Outlook for Hard Currency Trade Under Readjustment

China's economic strategy for the 1980's is expected to reflect closely the readjustment program begun in 1979. At least during the first half of the decade, Beijing presumably will concentrate on removing severe bottlenecks in the economy, spurring the expansion of export industries, and improving living standards. Agriculture and light industry should continue to be favored over heavy industry. Capital construction is expected to be held down over the next several years as Beijing tries to bring the state budget back into balance; the 1981 budget reportedly calls for a very significant cut in construction.⁹¹ As a result, the improvement and expansion of existing facilities should continue to take precedence over purchases of complete plants. An inadequate infrastructure, shortages of raw materials, and growing energy shortfalls should continue to hamper readjustment efforts.

According to Beijing, oil and coal production are expected to decline over the next several years.⁹² China also will be faced with rising unemployment, due in part from the cutbacks in construction and the closing of inefficient factories. In addition, Beijing may have to cope with higher inflation that threatens to undermine the wage increases won by workers.⁹³ The official Chinese estimate puts inflation for 1980 at 5.8 percent; however, the actual rate may be much higher.

As in the past, China in 1981-85 is expected to look to the West mainly for machinery, raw materials, technology, and grain. The rapid growth of imports over the last five years will be slowed by the combined impact of the retrenchment program with the cost-cutting measures. This will affect in particular purchases of Western equipment. Absorption problems also are expected to contribute to the slower pace of machinery imports. The Chinese have had particular difficulty in

⁸⁹ U.S. exports in 1980 reached a record \$3.7 billion, while U.S. imports totaled \$1.1 billion.

⁹⁰ See text accompanying notes 13-44 *supra*.

⁹¹ Financial Times, Mar. 2, 1981, at 1, col. 7.

⁹² Wall St. J., Dec. 29, 1980, at 10, col. 4.

⁹³ *Id.*

meeting the domestic requirements of large development projects in terms of basic infrastructure (transportation, power and communications) as well as raw material supplies and skilled labor. This is one of the reasons for the current drastic reduction in capital construction.⁹⁴

Whatever financial constraints on imports that exist during the 1981-85 period most likely would stem from the level of export earnings, rather than from the lack of available credits. Although China in the past several years had demonstrated a willingness to finance purchases of Western goods with foreign credits,⁹⁵ export earnings remain the most important factor in Beijing's determination of what it believes it can afford to buy.

The growth of China's hard currency exports, meanwhile, is expected to slow somewhat in 1981-85,⁹⁶ on account of Beijing's efforts to improve living standards, shortfalls in oil production, and growing Western protectionism. During the first half of the 1980's the sale of manufactures, particularly textiles and other light industry goods, is expected to continue to be the driving force behind China's hard currency export growth; many of the PRC's compensation agreements involve the production of these goods.⁹⁷ At the same time, rising oil prices may cause oil export revenues to increase, even if the export volume falls.

U.S.-PRC Trade Prospects Over the Next Five Years

U.S. trade with China over the next five years is expected to grow at a substantially slower pace than that achieved since the arrest of the Gang of Four in 1976.⁹⁸ Because the major legal impediments to bilateral trade already have been removed,⁹⁹ the successful resolution of any remaining obstacles, while improving the commercial climate, will have only a marginal impact on the level of trade. The growth of trade will be most affected by the combination of hard currency shortages, the extension of the readjustment program, and the country's inability

⁹⁴ About \$2.0 billion worth of Western equipment bought during the 1978 buying spree reportedly has been put in storage.

⁹⁵ In the 1978-80 period, official government credit agencies and private financial institutions extended over \$27 billion in credit lines to China. Very little of this money has actually been drawn down by the Chinese.

⁹⁶ Gullo, *supra* note 72, at 3.

⁹⁷ Chinese compensation agreements generally call for the Western firm to supply the capital, technical assistance, equipment and in some cases the raw materials or components at no charge while China provides the factory and labor. The Western partner then buys the finished goods at a discount, which allows it to cover the cost of its "investment".

⁹⁸ U.S. exports to the PRC since 1976 have increased at an average annual rate of 129 percent.

⁹⁹ See text accompanying notes 6-44 *supra*.

to absorb further substantial increases in imports; all of which will act to dampen China's demand for American products in 1981-85.

Agricultural commodities, such as grains, cotton and soybeans, are expected to continue to account for nearly two-thirds of all sales to the PRC over the next five years. Barring severe shortfalls in China's agricultural output, the volume of U.S. grain exports to the PRC should level off in part¹⁰⁰ because of the closing of the gap between domestic requirements and production. The U.S.-PRC Grains Agreement¹⁰¹ seems to insure that the U.S. will maintain its current role as China's leading supplier of foreign grain.¹⁰² China's rapidly growing demand for foreign cotton¹⁰³ is expected to be slowed, due in part to rising world prices. Because of the PRC's limited processing capability, U.S. exports of soybeans to China are projected to increase less rapidly than before. However, the PRC may increase its purchases of U.S. soybean oil to meet growing domestic demand. China over the past several years has looked to the U.S. to satisfy the bulk of its soybean import needs, and the U.S. now supplies over one-half of China's soybean oil import requirements.¹⁰⁴

U.S. manufactured exports to China are expected to continue rising, but at a pace well below the average annual rate of 78 percent registered since 1976. The general cutback in China's imports of Western machinery should reduce substantially the growth of U.S. equipment exports to the PRC over the next five years. Beijing will continue to be highly selective in its purchases of Western technology. Unless the U.S. product exhibits a clear technological advantage, as is the case of some oil equipment, computers, and electrical measuring and control equipment, China most likely will buy from countries that offer better financing.¹⁰⁵

Because of growing Chinese demand for intermediate goods

¹⁰⁰ The U.S.-PRC Grains Agreement, which will eliminate the wide fluctuations that characterized U.S. grain exports in the 1970's, *see* note 9 *supra*, guarantees annual U.S. sales through 1984 of at least 6 million tons of grain, 15 to 20 percent of which must be corn. Grain Agreement, art. 1, § 2, 81 DEP'T STATE BULL. No. 2046, at 13 (1981).

¹⁰¹ *See* BUSINESS WEEK, Jan. 19, 1981, at 38.

¹⁰² In 1980, the U.S. exported to the PRC 6.1 million metric tons of wheat worth over \$1 billion, roughly five times the 1979 level, and 1.7 million metric tons of corn valued at \$224 million.

¹⁰³ U.S. exports of cotton to the PRC in 1980 reached a record \$700 million, about two and one half times the 1977 level, and accounted for an estimated 90 percent of China's cotton imports from the West.

¹⁰⁴ U.S. soybean deliveries, which reached \$155 million in 1980, have increased ninefold since 1977. Meanwhile, PRC imports of soybean oil have more than doubled since 1977 and last year totaled an estimated \$60 million.

¹⁰⁵ Chinese demand for U.S. oil equipment could increase substantially when the pace of its

needed for light industry, U.S. exports of basic manufactures, mainly synthetic fabrics, tire fabric, paper products, and leather, should continue to register strong gains in 1981-85. U.S. exports of steel tubes and pipes, however, are expected to remain at a low level until the full measure of Beijing's efforts to develop China's offshore oil fields and expand existing onshore facilities is achieved.

U.S. chemical exports to the PRC should continue to increase but, consistent with the overall trend, at a slower pace, limited by China's foreign exchange constraints. With little additional production capacity expected over the next five years, Chinese demand for manufactured fertilizer should remain strong.¹⁰⁶ China's efforts to increase agricultural output also should insure continued strong demand for U.S. pesticides and herbicides.¹⁰⁷ The emphasis on expanding Chinese textile output will result in increased U.S. exports to the PRC of plastic materials, mainly polyester resins.

The growth of China's exports to the U.S.,¹⁰⁸ meanwhile, will be hindered by the limited range of goods the PRC has to offer. Increases in Chinese exports of textile goods, which currently account for roughly 30 percent of the PRC's total exports to the U.S., will be restricted at least through 1982 by the U.S.-PRC textile agreement.¹⁰⁹ In addition to limiting the growth of major Chinese apparel exports to the U.S., such as cotton knit blouses, cotton shirts and trousers, and synthetic fiber sweaters, the textile accord includes a mechanism for the levying of import quotas on other textile products.¹¹⁰ The U.S. already has curbed imports of Chinese wool sweaters under that mechanism,¹¹¹ and it is likely that quota negotiations on other items will be undertaken before the agreement ends in December 1982. When the current agreement expires, the U.S. most likely will seek a new bilateral accord that limits imports of Chinese clothing, or will impose unilateral restrictions if an agreement cannot be reached.

Growing protectionism also could limit the gains of other Chinese exports in the 1981-85 period. Although China's sales of footwear in the U.S. are small in comparison to footwear imports from other coun-

offshore oil development accelerates. See *The Development of China's Offshore Oil*, THE CHINA BUSINESS REVIEW, Jan.-Feb. 1980, at 23.

¹⁰⁶ The U.S. in 1979 satisfied roughly 12 percent of the PRC's import requirements.

¹⁰⁷ In 1979, the U.S. supplied about 30 percent of the PRC's hard currency insecticide imports.

¹⁰⁸ Since 1976, Chinese exports to the U.S. have increased at an average annual rate of 51 percent.

¹⁰⁹ 80 DEP'T STATE BULL. No. 2044, at 12 (1980).

¹¹⁰ *Textile Agreement*, *supra* note 25, art. 8.

¹¹¹ 45 Fed. Reg. 70960 (1980); U.S. apparel imports from China in 1980, the first year of the bilateral accord, increased by about \$100 million to an estimated \$250 million.

tries such as South Korea and Taiwan, the sudden surge of volume has brought complaints from U.S. shoe manufacturers.¹¹² Chinese exports of prepared foods to the U.S. may run into similar problems. An outcry from domestic producers resulted in higher tariffs on Chinese canned mushrooms.¹¹³ Dumping charges were filed against the PRC in June 1980 regarding Chinese sales of natural menthol. Although it was determined that the PRC was exporting natural menthol to the U.S. at less than fair market value, it was found that these imports did not materially injure or threaten material injury to a U.S. industry.¹¹⁴

Supply constraints are expected to hold down PRC sales of fuels and other raw materials to the U.S. in 1981-85. Because of the expected decline in China's oil production, the volume of oil exports to the U.S. probably will fall. Petroleum deliveries were largely responsible for the recent jump in U.S. crude material imports from China and were a major contributor to the rapid growth of U.S. total imports from the PRC.¹¹⁵

The outlook for substantial increases in exports of other crude materials, such as nonferrous metals, also appears slim, at least over the next five years. Because of production limitations, Chinese exports of nonferrous metal to the U.S. are not expected to play a major role in U.S.-PRC trade in 1981-85.¹¹⁶ Several projects that were designed to help boost China's nonferrous metal output reportedly have been postponed or cancelled.¹¹⁷

CONCLUSION

Our attempt to present an objective view of the current status and future prospects for trade with the People's Republic of China, based as it is on both Chinese and foreign analysis, must be understood in light of the riskiness of all future trade projections. In the case of China, where the events of the past two decades, and especially the last two

¹¹² See *THE CHINA BUSINESS REVIEW*, Jan.-Feb. 1981 at 22.

¹¹³ 45 Fed. Reg. 72617 (1980).

¹¹⁴ An antidumping petition was filed with the Department of Commerce on June 11, 1980. An investigation was initiated, 45 Fed. Reg. 44976 (1980), and a finding of material injury to a U.S. industry was made. 45 Fed. Reg. 52273 (1980). An analysis concluded that the PRC is exporting natural menthol at about 2.5 percent less than fair market value. 45 Fed. Reg. 3258 (1981).

¹¹⁵ U.S. oil imports from the PRC in 1980 increased by about \$40 million over 1979 to \$134.7 million. Most of the increase stemmed from a shift in imports away from crude toward higher priced oil products.

¹¹⁶ In 1980, Chinese exports to the U.S. of nonferrous metals, mainly tungsten ore and bauxite, increased by roughly \$20 million to \$35 million.

¹¹⁷ See *THE CHINA BUSINESS REVIEW*, Jan.-Feb. 1980, at 11.

years, have indicated that trade policy is subject at any time to change, this certainly must be kept in mind. Nonetheless, on present data, the analysis presented here is a realistic one. While the level of U.S.-China trade will not continue to expand as rapidly as it has the past two years, the China market should continue to provide new opportunities for American business and new challenges for American attorneys.