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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

28 March 1986

China's Foreign Trade in 1985 and Prospects for 1986 [redacted] 25X1

Summary

Over the past year, Beijing has tightened its control of the foreign trade apparatus, largely in response to declining foreign exchange reserves and a sharply rising trade deficit. High demand in China's industrial sector, however, will keep imports high, while increasing protectionism in the West will continue to dampen export growth. Moreover, lower prices for petroleum and petroleum products--which represent approximately one-fifth of the country's export revenues--will decrease Beijing's foreign exchange earnings. In an effort to narrow its trade deficit, we believe Beijing will continue to exert more control over its foreign trade as a means of reducing imports in the face of expected low export growth. We believe, however, that the impact on US exports to China will be marginal. [redacted] 25X1

This memorandum was prepared by [redacted] Office of East Asian Analysis. 25X1
Information available as of 28 March 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, China Division, OEA, [redacted] 25X1
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After more than five years of progressive liberalization of many foreign trade practices, over the last year Beijing has begun to reimpose selected central controls over foreign trade. The reassertion of control by the Ministry of Foreign Economic Relations and Trade (MFERT) is apparently in response to a 25-percent decline in foreign exchange reserves between September 1984 and September 1985, and to the leadership's concern about a growing trade deficit. Although Beijing's current level of foreign exchange reserves is sufficient to cover three months' imports, Chinese officials prefer to maintain a five-month foreign exchange reserve cushion. [redacted] 25X1

One Step Back for Decentralization

Recentralization began with MFERT regaining control over the establishment of new trading organizations. China's open-door policy had given rise to a proliferation of import-export companies, many of which lacked the necessary skills for conducting trade. As a result, foreign and domestic traders encountered considerable confusion. Moreover, the competition among the many Chinese entities--both national and provincial--authorized to trade had initiated a price war, driving down the prices of China's exports and dampening foreign exchange earnings. Under the new guidelines, a new organization may be approved only if its business scope does not overlap existing companies and the new firm has qualified personnel. [redacted] 25X1

In another move to strengthen management over foreign trade, last spring MFERT implemented a system of licensing imports and exports. Initially export licenses were required for 30 products; later the list was trimmed to 15 key export products. Last fall, however, Beijing broadened its export license requirement to 151 items, covering almost every major product the country exports. Import licenses were also imposed to dampen the flow of incoming goods--many of which China could produce domestically--and to conserve foreign exchange. In addition, in the past year Beijing announced changes in its customs regulations--increasing some tariffs to protect infant industries from imports, reducing import duties on some goods including raw materials and high-technology items, and abolishing nearly all export duties. These measures will help reduce the variation in local assessments of duties and licenses, which had caused confusion among foreign traders. [redacted] 25X1

Despite these measures, China posted a record $14.9 billion trade deficit last year, according to Chinese customs statistics. Imports soared more than 50 percent in 1985 as rapid industrial growth and high consumer demand--sparked by an increased money supply--led to sharply higher purchases of raw industrial materials and consumer durables. Although petroleum export revenues increased, earnings by other major exports--such as textiles and apparel--were sharply lower and, according to Chinese data, overall export earnings rose by only 6 percent. [redacted] 25X1

The Search for New Export Markets

Developing New Partners. While Beijing recorded only a marginal increase in exports to its major trading partners (Hong Kong, Japan, and the United States), its

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exports to the Soviet Union, Latin America, and Eastern Europe showed substantial increases. We estimate that exports to the Soviet Union increased more than 35 percent over 1984, along with an additional 22-percent increase in goods to Eastern Europe. Exports to Mexico and Chile more than tripled in 1985, reflecting Beijing's strong interest in developing ties to Latin America. 25X1

Hong Kong continues to be China's largest export market, accounting for more than one-fifth of China's total trade. Beijing has actively pursued closer economic links to promote the territory's stability and prosperity. Moreover, China is particularly in need of a host of services that Hong Kong can provide--financial, trade, and shipping. Earlier this year, Hong Kong opened an office in Beijing to further promote trade--its first official representation in China--with a second office scheduled to open in Shanghai before yearend. 25X1

Moving Into New Commodities. Although grain output fell 7 percent, China became a net exporter of grain last year, almost tripling grain export levels to over 9 million metric tons. Imports--15 percent of which were from the United States--totaled about 5.4 million metric tons. Corn constitutes nearly half of China's grain exports with the balance in soybeans and rice. Sales to Hong Kong, the Soviet Union, West Germany, the Philippines, and Singapore account for more than half of China's grain sales. 25X1

Although revenues from exports of petroleum and petroleum products jumped 25 percent in 1985, Beijing's search for new export markets will intensify this year as China feels the effects of lower oil prices. For the past six years, petroleum and petroleum product exports have accounted for roughly one-fifth of total export earnings, amounting to nearly $6.4 billion in 1985. If Beijing carries out its promise to hold oil export volume at the 1985 level in support of OPEC's attempts to shore up oil prices, China could lose at least $1.6 billion in foreign exchange earnings this year.[1] 25X1

For the next few years, we expect manufactured goods to provide the largest source of export growth as the Chinese substitute sales of processed goods for raw materials wherever possible. In addition to the higher value-added earnings that processed goods command, this strategy is also directed toward compensating for the increase in volume quotas developed nations impose on imports from China. The Chinese are also attempting to increase their gains from trade by moving into exports that reflect their comparative advantage in labor-intensive manufactured goods. For example, earlier this year, Beijing announced its plan to export $1.5 billion worth of carpets in the next five years and established the China Carpet Import and Export Association to coordinate international sales. 25X1

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[1] This assumes that oil prices will average $18 per barrel in 1986 and that petroleum products--nearly 20 percent of China's oil-related export volume--will earn approximately 25 percent more per barrel than crude. 25X1

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Implications for the United States

China has little chance of turning to alternative commodities to compensate for the expected drop in oil export revenues--attempts over the past several years to diversify exports have met with limited success. Hence, Beijing will probably focus on slowing runaway imports. We believe much of the slowdown in import growth will be effected through stricter foreign exchange controls, including an additional curtailment of the purchase authority previously granted to local traders under decentralization. Beijing will also continue other restrictive measures such as import licensing and selective tariff increases. According to Hong Kong press reports, Beijing's attempts to conserve foreign exchange are driving some small, marginal Chinese import-export companies out of business. These same sources caution that, because of foreign exchange shortages, China may also renege on negotiated contracts--similiar to the cancellations of grain and synthetic fiber contracts that occurred in 1983. 25X1

We believe that tightening import restraints will change the composition of China's purchases over the next year. Restrictions are already in place on commodities that China can produce domestically, including such consumer durables as color televisions, refrigerators, radios, and motor vehicles. But Beijing will also need to cut deeper into its import shopping list. We believe these cuts will begin with capital equipment purchases for postponed or cancelled government projects. 25X1

We believe, however, Beijing will continue to encounter problems slowing economic growth and therefore will achieve only moderate success in reducing industrial and capital equipment purchases. Consequently, the effect on US exports to China, more than one-third of which are machinery and transport equipment, will be marginal. Moreover, demand for raw materials and chemicals--which represent an additional 25 percent of US exports to China--probably will also be sustained. 25X1

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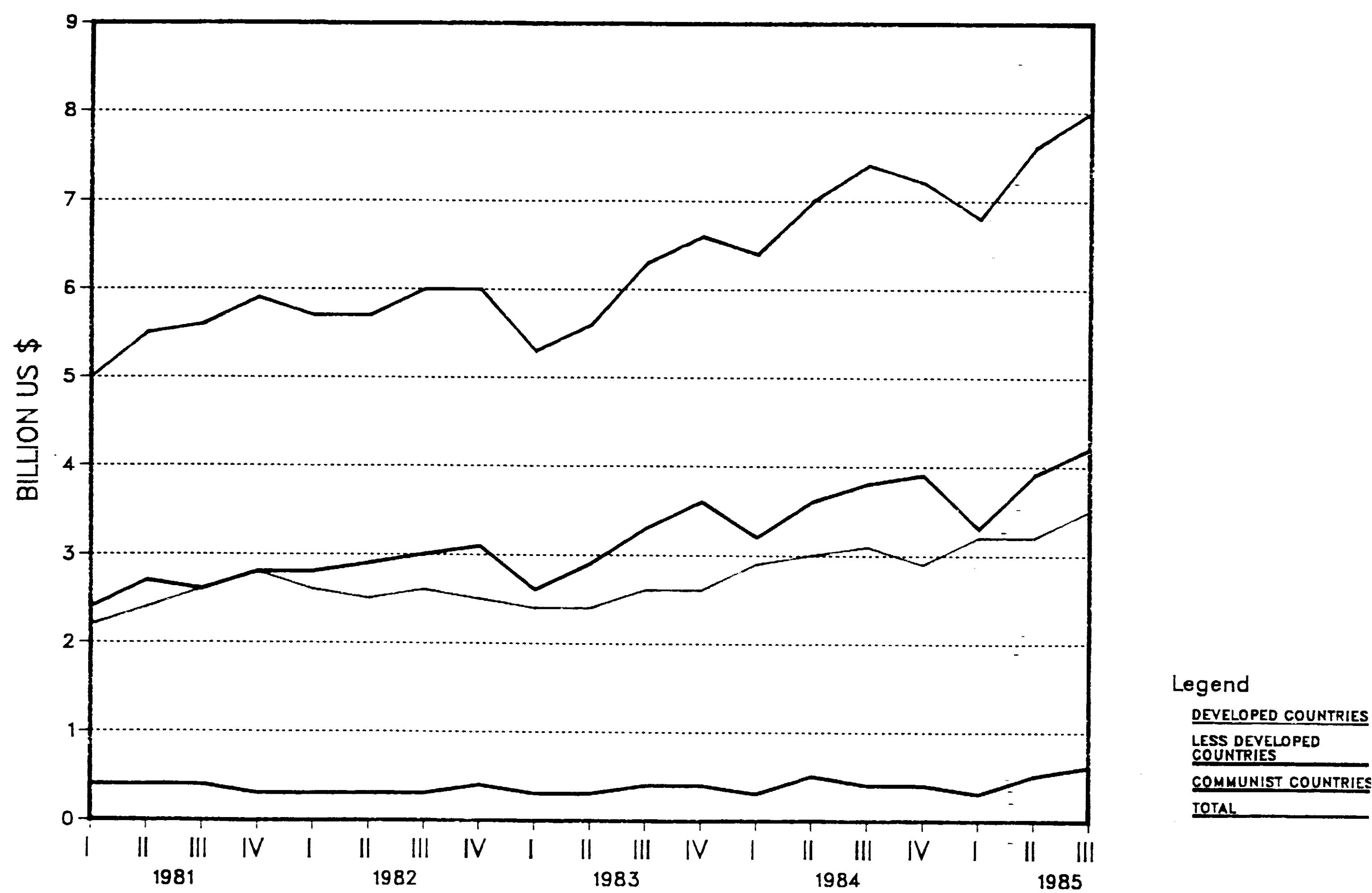

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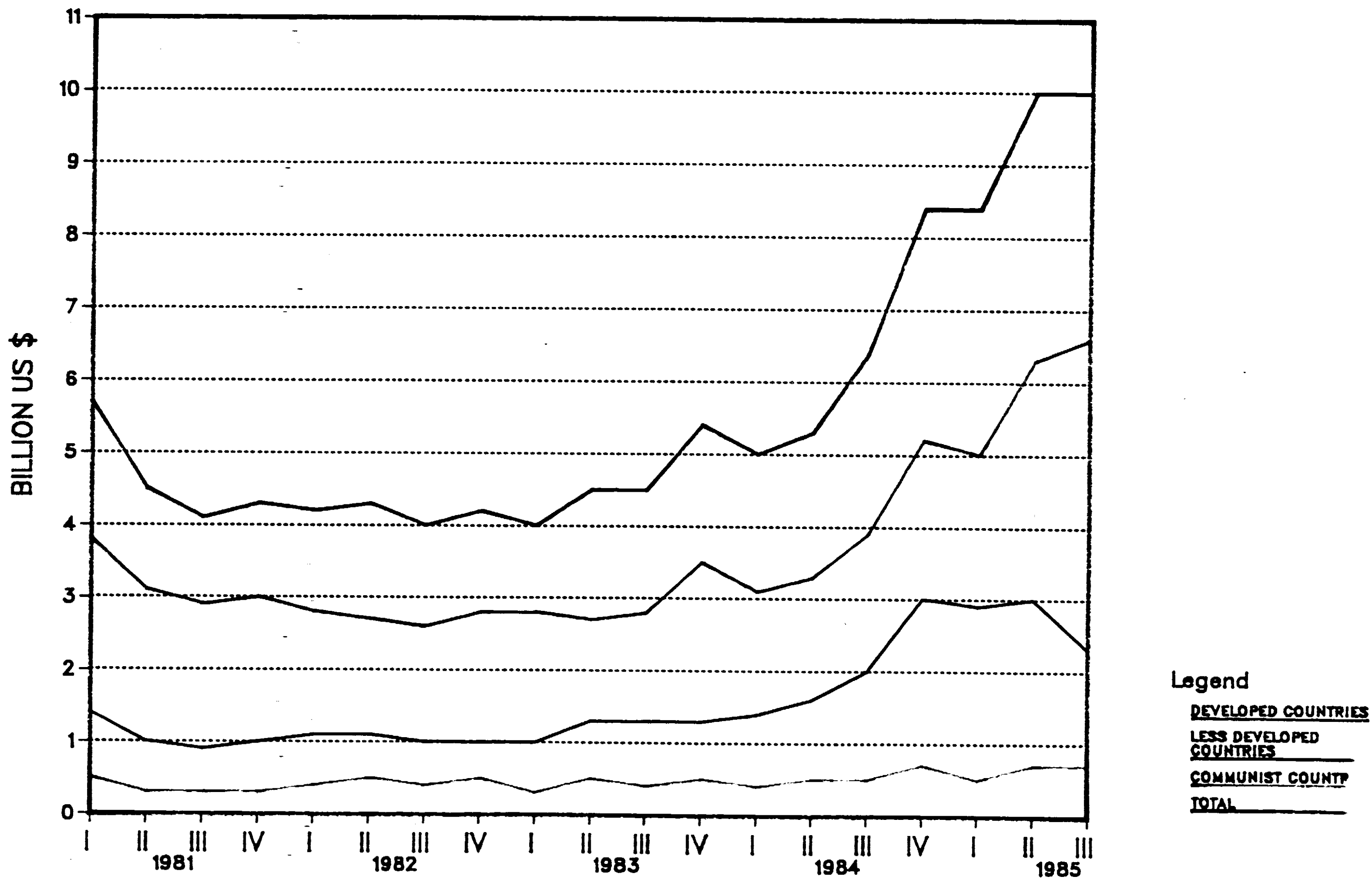
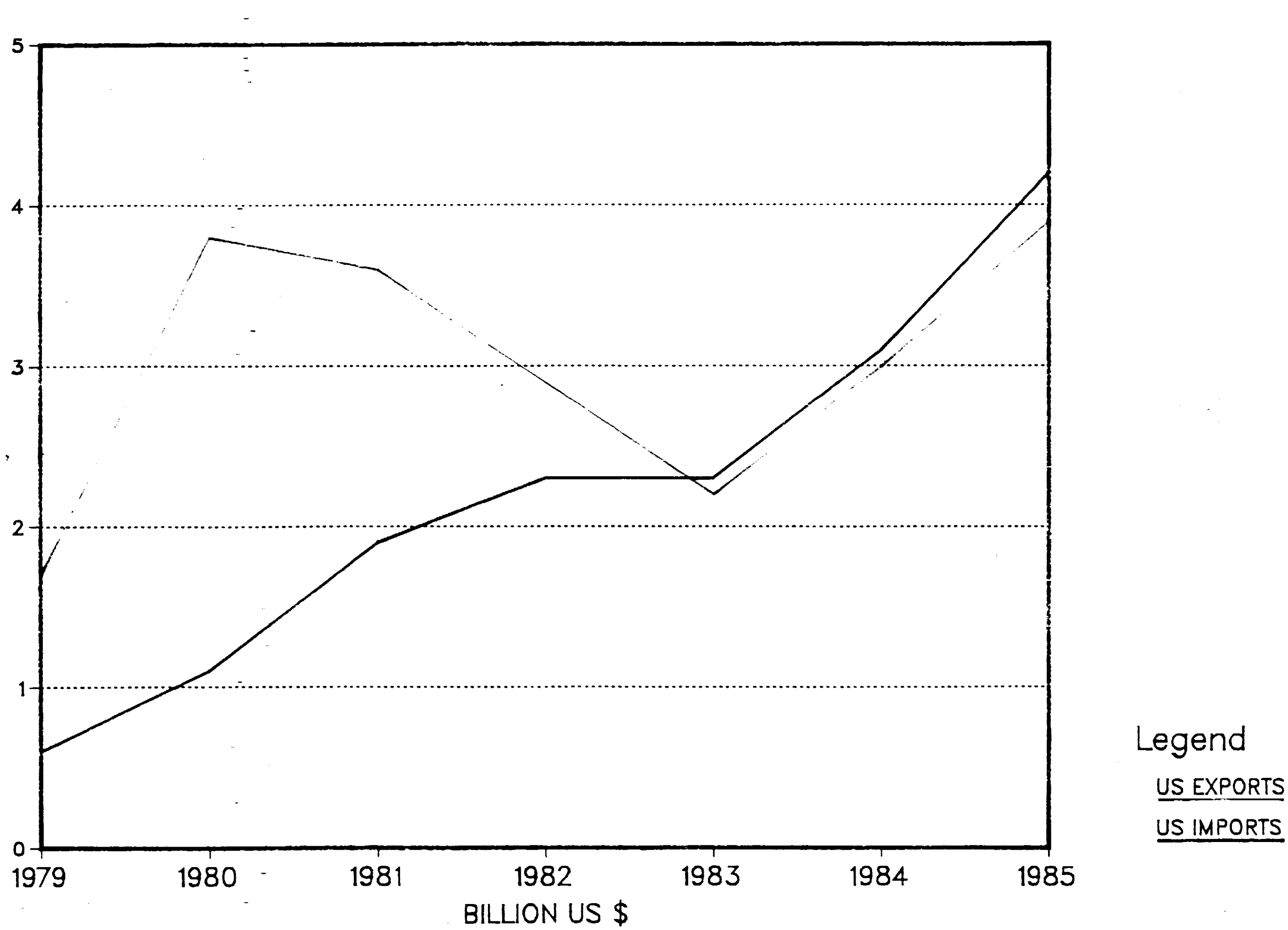


UNITED STATES—CHINA TRADE



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