Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

26 February 1986

China: The Impact of Lower Oil Prices on Trade

Summary

Declining oil prices and Beijing's recently announced freeze on oil export levels could cost China $1.6 billion in foreign exchange earnings this year. Already struggling with a $13.7 billion trade deficit, Beijing will, we believe, tighten foreign exchange controls and increase import restrictions. These controls may affect China's efforts to attract foreign joint ventures; US exports to China, however, will be affected only moderately, with the weight of import cutbacks falling on Japan. [redacted] 25X1

Reduced Oil Revenues

Since 1979, petroleum and petroleum products have been a major component of China's export revenues, accounting for approximately one-fifth of total export earnings. The depressed oil market, however, threatens this important source of foreign exchange. [redacted] in the last month China cut nearly $6 off its per-barrel price of oil. Although in the past China has steadily increased exports by undercutting OPEC prices, last month Beijing announced it would support OPEC and hold 25X1

This memorandum was prepared by [redacted] Office of East Asian Analysis. Information available as of 26 February 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Development Issues, China, OEA [redacted] 25X1 25X1

EA M 86-20022

[redacted] [redacted] 25X1 25X1

[redacted] 25X1

[redacted] 25X1

this year's oil exports at their 1985 levels. Consequently, we estimate China's earnings from petroleum exports could decline $1.6 billion from last year's earnings of nearly $6.4 billion.[1] [redacted] 25X1

This loss will exacerbate Beijing's efforts to correct its growing trade deficit, which reached a record $13.7 billion last year according to Chinese Customs statistics. Imports soared by 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 by nearly 25 percent over those of 1984, earnings by other major exports--textiles, apparel--were sharply lower and, according to Chinese data, overall export earnings rose by only 6 percent. [redacted] 25X1

Beijing's Response

With little chance of turning to alternative commodities to compensate for the expected drop in oil earnings, Beijing will need to slow its runaway imports to reverse the growing trade deficit. 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 could drive some small Chinese import and 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. [redacted] 25X1

Stricter foreign exchange allocation will also affect attempts to attract foreign joint ventures in China. [redacted] 25X1 In addition, we expect that tightened foreign exchange will result in the postponement or cancellation of many Chinese ventures that require substantial capital imports. [redacted] 25X1

Tightening import restraints would 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, radio cassettes, and motor vehicles. But Beijing will also need to cut deeper into its import shopping list to compensate for the expected $1.6 billion drop in

---

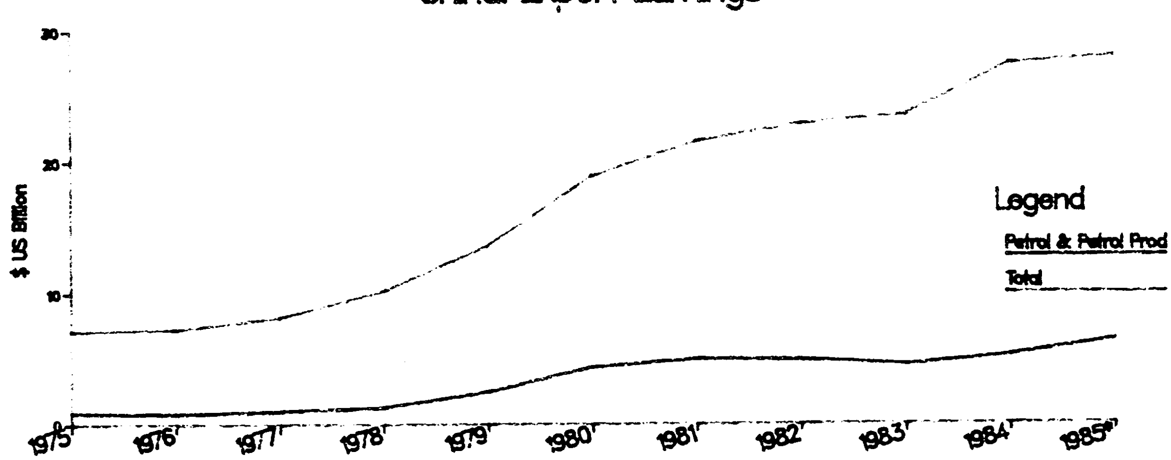
[1] This assumes export volume at the 1985 level and an average price of $18 per barrel. Petroleum products--nearly 20 percent of oil-related export volume--earn approximately 25 percent more per barrel than crude. [redacted] 25X1

[redacted] 25X1

China: Trade Balance

* Estimated.

China: Export Earnings



* Estimated

[redacted] 25X1

foreign exchange. We believe these cuts will begin with capital equipment purchases for postponed or cancelled government projects. We also expect Beijing will continue its efforts to slow down its overheated economy, which grew at an estimated 18 percent last year. If successful, China's high imports of raw industrial materials would be reduced. [redacted] 25X1

Impact on US Exports

We believe 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--should also be sustained. [redacted] 25X1

While the impact on US trade will be relatively low, we believe Japan--China's largest trading partner--will suffer most from Beijing's import cutbacks. With a $6.5 billion trade surplus with China last year, Tokyo has already come under fire from Chinese officials as a major contributor to Beijing's deficit problems. During 1985, the volume of many Japanese exports to China doubled--computers, copiers, televisions, tape recorders, automobiles, refrigerators, and washing machines--leading to a phenomenal 73-percent increase in Japan's exports to China. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

China: The Impact of Lower Oil Prices on Trade

Distribution:

<u>National Security Council</u>
1 – David Laux, Senior Staff Member for China, Taiwan, and Hong Kong, Room 302, Old Executive Office Bldg., NSC
<u>Department of State – Bureau of East Asian & Pacific Affairs</u>
1 – Joan Plaisted, Office of Chinese Affairs, Room 4318
1 – Robert Goldberg, Office of Chinese Affairs, Room 4318
1 – Doug Paal, S/P, Room 7330
<u>Department of State – Bureau of Economic & Business Affairs</u>
1 – Robert Price, Director of East-West Trade, Room 3819
<u>Department of State – Bureau of Intelligence & Research</u>
1 – Chris Clarke, China Division, Office of Analysis for East Asia and the Pacific, Room 8840
1 – John Danylyk, Chief, Communist Economic Relations Division, Office of Economic Analysis, Room 8722
<u>Department of the Treasury</u>
1 – Mary Yee, Office of East-West Economic Policy, Room 4450
<u>Department of Commerce</u>
1 – Myna Stoltz, Country Policy Analysis, East Asia and Pacific, Room 3820
<u>Office of the US Trade Representative</u>
1 – William Abnett, Director of China Affairs
<u>Department of Agriculture</u>
1 – Frederick Surls, Economic Research Service, GHI Bldg., Room 350
<u>Defense Intelligence Agency</u>
1 – [redacted] DB4E2, Pentagon 25X1
<u>Department of Energy</u>
1 – Douglas Faulkner, Room GA257, Forrestal Bldg.
<u>Central Intelligence Agency</u>
2 – C/OEA/CH
1 – C/OEA/CH/FOR
1 – C/OEA/CH/DEF
1 – C/OEA/CH/DOM
1 – OEA/Research Director, 4G48
1 – D/OEA, 4F18
1 – DDI, 7E44
1 – Senior Review Panel, 5G00
1 – PDB Staff, 7F30
1 – NIO/EA, 7E62
1 – C/PES, 7F24
1 – FBIS/NEAAD/China Branch, 306 Key
1 – C/EA/[redacted] 5E18 25X1
1 – OCR/ISG, 1H19
1 – CPAS/ILS, 7G50
5 – CPAS/IMC/CB, 7G07
1 – Author
1 – Chrono

[redacted] 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP86T01017R000605740001-8

[redacted] 25X1

[redacted] 25X1
OEA/CH/DEV[redacted]/25Feb86

[redacted] 25X1