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MFN for China

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THE WHITE HOUSE
Office of Cabinet Affairs
Routing Slip

From: Blumenthal Date: 6-14

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| Williamson | <u>1</u> | <u>NW</u> | <u>R</u> |
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A=Action I=Information R=Review D=Dispatch

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Comments:

THE WHITE HOUSE

WASHINGTON

June 14, 1991

MEMORANDUM FOR EDE HOLIDAY

FROM: GARY BLUMENTHAL *GB*

SUBJECT: China MFN

I will work with Bobbie on getting more help from the agriculture community on China MFN. In the meantime, thought you'd find the attached Farm Bureau letter of interest.

Individually addressed to all members of the
House and Senate

**A FARM BUREAU
SPEEDLINE**

June 11, 1991

The Honorable
U.S. House of Representatives
Washington, DC 20515

Dear Representative:

The American Farm Bureau Federation, the nation's largest organization of farmers and ranchers, strongly supports extension of non-discriminatory most-favored nation (MFN) tariff treatment to China.

Withdrawal of MFN tariff treatment would halt all U.S. imports from China and result in Chinese retaliation against American farm commodities. Our agricultural exports to China were valued at over \$800 million in 1990, and included livestock products, wheat and cotton.

Retaliation is certain for two reasons: First, China retaliated against U.S. farm products the last time the United States restricted imports of Chinese products, from 1983 to 1986.

Second, denial of MFN treatment to a country results in prohibitive and discriminatory U.S. tariffs on that country's products. Despite what has been repeatedly reported, the granting of MFN to a country does not mean that country receives "the most favorable tariff treatment in the United States." Some 104 countries and another 26 foreign territories receive better-than-MFN treatment under the Generalized System of Preferences. A number of those countries also receive better-than-MFN treatment under the Caribbean Basin Economic Recovery Act (popularly known as CBI). In addition, Canada and Israel receive better-than-MFN treatment under free trade agreements.

Granting MFN treatment to China simply puts China on an equal footing with about two dozen developed countries. There is nothing especially favorable about that tariff treatment. On the other hand, to deny MFN treatment would place China in a category with only 14 other countries against which the United States imposes prohibitive and discriminatory tariffs, and with which we carry out very little trade. Let there be no mistake, the result of applying such prohibitive tariffs would be that Chinese products simply could not compete with the vast majority of other countries in the U.S. market and virtually all trade between the two countries would end. For some opponents of MFN, this may in fact be their main objective.

No one can condone the political repression that exists in China, but withdrawing MFN is not the answer to that problem. If the United States applies discriminatory tariffs against Chinese goods, China will discriminate against the United States in its purchases of agricultural products. American farmers will once again take the main hit for our government using trade policy as a political weapon.

Sincerely,

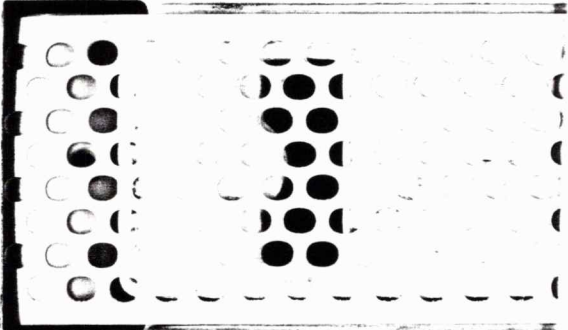
Dean R. Kleckner
President

DRK/jb



AMERICAN FARM BUREAU FEDERATION

100 Maryland Drive, N.W., Suite 300 • Washington, D.C. • 20004 • 202/484-3800

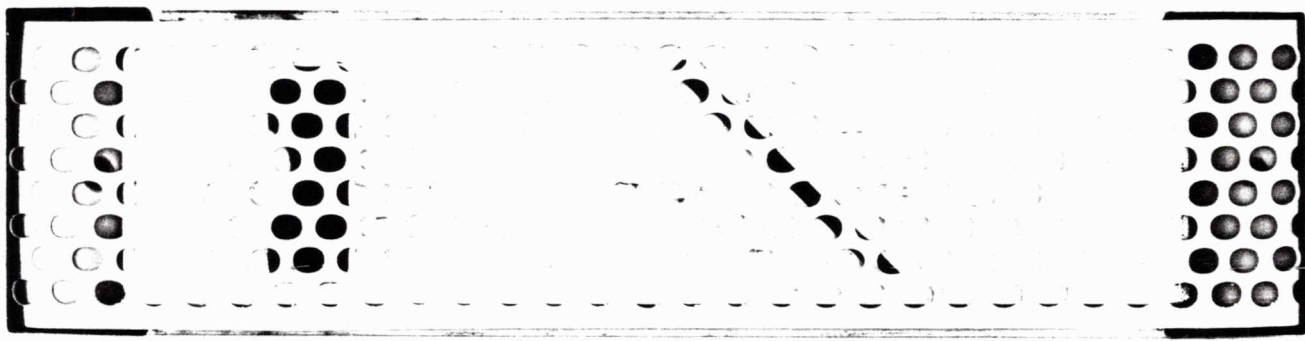


THE WHITE HOUSE
WASHINGTON

TO: *Orin*
FROM: EDE HOLIDAY *JA*

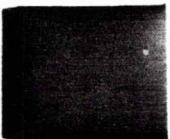
*Steve F.
Claire
Todd
Gary
E.H.*

- FYI
- Action
- Comment




THE WHITE HOUSE
WASHINGTON

7-19-91




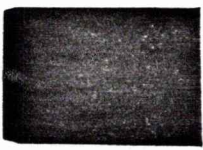
Dick Darman
Andy Card
Ede Holiday

TO:

FROM: **FRED McCLURE** 
**Assistant to the President
for Legislative Affairs**

- FYI
- Comment
- Action

Attached please find copy of President's reponse
to Senator Max Baucus on China-MFN. (Identical
letter sent to Leader Bob Dole)



THE WHITE HOUSE

WASHINGTON

July 19, 1991

Dear Senator Baucus:

I appreciated receiving your views on the importance of renewing China's most-favored-nation (MFN) trade status while also seeking to achieve progress with the Chinese on issues of vital concern to the American people. We clearly share the same goals. We want to see China return to the path of reform, show greater respect for human rights, adhere to international norms on weapons sales, and practice fair trade. China should contribute to international stability and not detract from it.

You rightly note that withdrawing MFN would hurt not only Americans but also the people of Hong Kong and the millions in China who are working for progressive change. Continuing MFN is essential to protect American consumers and exporters, and to support the economic forces that have been driving reform in China for more than a decade. It is no accident that the process of reform accelerated with the increase in foreign businesses operating in that nation. Those who would end political and economic reform in China have the most to gain if MFN were withdrawn. It is the economic forces pressing for the loosening of state control and increased personal freedom that would suffer the most. Other losers would be the thousands of American workers and farmers who together produced in 1990 almost \$5 billion in exports to China.

Since we started the process of normalizing contacts with China in the 1970s, there has been strong bipartisan support for the U.S.-China relationship. Building on the three U.S.-China communiques, U.S. interaction with the government and people of China has produced demonstrable progress. That interaction must continue despite the recent severe setbacks. Nevertheless, I support the view that strong measures are needed to address our concerns in China and have not hesitated to use them in a targeted fashion. To underscore our deep dismay about human rights violations, I have kept in place a number of sanctions since the Tiananmen Square crackdown which have affected arms sales, high-level contacts, U.S. economic programs and U.S. support for multilateral development bank lending to China.

The U.S. is currently the only nation maintaining its Tiananmen sanctions and refusing to normalize relations until China makes substantial progress on human rights. For example, while all our allies and other World Bank members have supported virtually all of the last sixteen World Bank loans to China, we have declined

to support seven because the loans would not serve basic human needs.

At the London Summit, we raised China's human rights practices with our G-7 allies and encouraged them to continue to stress to China's leaders, as we have repeatedly, the importance that democratic governments attach to human rights. We made clear that the U.S. will continue its policy of supporting only those multilateral development loans for China that serve basic human needs (BHN), and our view that any non-BHN lending to China help to promote market-oriented economic reform.

To advance our nonproliferation objectives, I recently authorized a number of steps aimed at engaging the Chinese on their weapons transfer policies and making clear our dissatisfaction with transfers that contribute to regional instability. The Under Secretary of State for International Security Affairs recently traveled to Beijing for a detailed discussion of nonproliferation issues, including our specific concerns about Chinese exports. He pressed for China's adherence to the Nuclear Nonproliferation Treaty and the Missile Technology Control Regime, actions I called for in my commencement speech at Yale University on May 27. We are pleased with the constructive role China played in the July 8-9 Middle East arms control talks in Paris. The Chinese endorsed all the key objectives of my Middle East arms control initiative (such as efforts to freeze and ultimately eliminate surface-to-surface missiles and block the production and acquisition of nuclear useable material). The Chinese also agreed to work rapidly in follow-on meetings to flesh out the broad agreements reached in Paris.

At the same time, I have also taken measures to emphasize to China that the U.S. is concerned about reports of destabilizing missile-related transfers. In April, I rejected requests for licenses to export satellite components for a Chinese communications project because of the involvement of Chinese companies in unacceptable missile equipment transfers. Just recently, I approved trade sanctions against two Chinese companies for that same reason. In addition, I directed that no further licenses of high-speed computers and no further exports of satellites to China be authorized until our concerns that China adhere to accepted international nonproliferation standards are satisfactorily addressed. The U.S. will be coordinating with other countries in order that these measures not be undercut. Our experience has demonstrated that such consultations will lead to effective, multilateral technology transfer restrictions.

I have also instructed U.S. agencies to press vigorously our concerns about Chinese unfair trading practices. In April, I directed the U.S. Trade Representative to identify China as a priority foreign country under the Special 301 provisions of the Trade Act for failing to protect U.S. intellectual property

rights. If China does not make real progress during the 301 investigation, trade action will follow. Beyond intellectual property protection, my Administration has invited senior Chinese trade officials to Washington in August for continuation of consultations begun in June regarding access for U.S. products to the Chinese market. If these talks fail to produce Chinese commitments to take substantial measures to improve market access, the Administration will self-initiate further action under Section 301 of our trade laws.

We are strictly enforcing the terms of our textile agreement with China and have already made charges against China's quota because of illegal textile shipments through third countries totalling approximately \$85 million so far. Following consultations in July, we expect to make additional charges. If China does not exert effective control over these illegal shipments, we are prepared to take additional action against China.

Charges that China exports goods produced with prison labor are a matter of serious concern. The Customs Service is investigating these charges. In addition, we have obtained a firm high-level commitment to prevent the sale of prison labor products to the United States. We will continue to monitor China's behavior in this area closely and will strictly enforce relevant legislation concerning prison labor exports. In particular, I am ordering the following additional measures: The Department of State will seek to negotiate a memorandum of understanding with China on procedures for the prompt investigation of allegations that specific imports from China were produced by prison labor. Pending negotiation of this agreement, the U.S. Customs Service will deny entry to products imported from China when there is reasonable indication that the products were made by prison labor. The denial will continue until the Chinese Government or the Chinese exporter provides credible evidence that the products were not produced by prison labor.

I am also instructing the U.S. Customs Service to identify an office to receive information on prison labor exports and establish procedures for the prompt investigation of reports of prison labor exports from interested parties. Additional customs officials will be directed to identify prison labor exports and aid in uncovering illegal textile transshipments.

Although it is not directly related to China's MFN status, I share your interest in Taiwan's accession to the GATT. As a major trading economy, Taiwan can make an important contribution to the global trade system through responsible GATT participation. The U.S. has a firm position of supporting the accession of Taiwan on terms acceptable to GATT contracting parties. The United States will begin to work actively with other contracting parties to resolve in a favorable manner the issues relating to Taiwan's GATT accession. Because China, our

tenth largest trading partner, could also make an important contribution to the global trading system, I will seek to have the Chinese Government take steps on trade reform so that China's GATT application can advance and its trade practices can be brought under GATT disciplines through the Working Party formed for China in 1987. U.S. support for Taiwan's accession to GATT as a customs territory should in no way be interpreted as a departure from the long-standing policy of five administrations which acknowledges the Chinese position that there is only one China, and that Taiwan is part of China.

In sum, therefore, I am prepared to address the concerns you and your colleagues have identified, and I am doing so. But discontinuing MFN, or attaching conditions to its renewal, would cause serious harm to American interests and would render futile pursuit of the initiatives I have outlined, which are discussed in greater detail in the attachments. Working together, I believe we will best protect America's interests by remaining engaged with China and the Chinese people.

Sincerely,



P.S. At the recently concluded G-7 Summit in London, the leaders of these Western Democracies all urged renewal of MFN.

Attachments:

- Part I - Human Rights
- Part II - Nonproliferation
- Part III - Trade and Economic Issues

The Honorable Max S. Baucus
United States Senate
Washington, D.C. 20510

PART I: HUMAN RIGHTS

Human rights concerns have been at the heart of our relationship with the PRC since the tragic events of June 1989. Every high-level meeting since that time has at least touched on human rights issues, and several -- such as the December 1990 visit to China by Assistant Secretary Schifter -- have been devoted exclusively to them. We have consistently stressed to the Chinese leadership that there can be no return to the kind of relationship we enjoyed before 1989 without substantial improvements in China's human rights practices.

Our overall approach on human rights issues has consisted of:

Public expression of concern

- President Bush condemned the brutal suppression of demonstrations in Tiananmen Square in June 1989, the first world leader to do so. He declared May 13, 1990 a National Day in support of Freedom and Human Rights in commemoration of the 1989 demonstrations, and issued another statement to mark the anniversary of the crackdown in 1991.
- In our human rights reports for 1989 and 1990, we were fair but hard-hitting, and as accurate as available information would allow. These reports have drawn high praise from human rights groups, and harsh condemnations from the Chinese government.
- The State Department issued a statement on January 9, 1991 condemning the trials of nonviolent dissidents.
- In April 1991 the President met the Dalai Lama at the White House to demonstrate our respect for His Holiness' nonviolent approach to conflict resolution and our concern for human rights problems in Tibet.

Suspension of bilateral programs

On June 6 and June 20, 1989, the President announced the suspension of a number of bilateral programs and changes in U.S. approach to multilateral issues until the human rights climate in China improved. Those suspensions generally remain in effect.

- A multitude of high-level exchange visits that would normally have taken place since 1989 have been canceled. Only a very limited number of visits at and above Assistant Secretary level have been approved on a case-by-case basis, and only when they addressed issues of key concern to the United States, e.g., like human rights, nonproliferation, unfair trade practices, and narcotics.
- Military exchange visits have been suspended completely.

- Work on several existing military equipment and technology projects has been suspended indefinitely.
- We have stopped the transfer of military or dual-use equipment or technology to Chinese military and security services.
- The U.S. sought to postpone all multilateral development bank loans to China from June 1989 to January 1990. Since then, we have supported only those loans that serve the basic human needs of the Chinese people.
- We have suspended grants, loans and insurance guarantees to China under the Trade and Development Program and OPIC.
- We have worked through COCOM to suspend planned liberalization of export controls to China.

Engagement in dialogue

Through the few high-level visits that have been authorized, and through regular diplomatic channels, we have engaged the Chinese government in an unprecedented continuing dialogue on a wide range of human rights issues.

- The Scowcroft-Eagleburger missions of July and December 1989 were devoted primarily to laying out our human rights concerns and suggesting steps the Chinese could take to address them.
- During Chinese Foreign Minister Qian's visit to Washington in November 1990, President Bush and Secretary Baker reiterated the need for progress on human rights, and stressed that human rights is a cornerstone of American foreign policy.
- Assistant Secretary Schifter visited China in December 1990, the first time our top human rights official has done so. In sixteen hours of intense discussions with senior Chinese officials, he spelled out in detail our human rights concerns in a wide range of areas including accounting of detainees, release of political prisoners, denial of due process and fair and open trials, treatment of prisoners, divergence of Chinese law from international standards, respect for freedom of religion, abusive implementation of family planning regulations, and human rights problems in Tibet. He delivered a list of 151 representative cases of reported political incarceration, and asked Chinese authorities to clarify the status of the cases and release those whose imprisonment violated international norms. He suggested changes in Chinese laws and judicial processes that would bring them into conformity with international standards.

- Under Secretary Kimmitt in May 1991 reiterated many of the points made by Assistant Secretary Schifter, and called on the Chinese government to declare an amnesty for all those imprisoned for nonviolent political activities. He also urged the Chinese to implement effectively their claimed prohibition on export of prison labor products.

Results of actions

Most importantly, the Chinese government has acknowledged the legitimacy of human rights as a subject of bilateral discussion, both with us and with other concerned governments. They received a Congressional delegation devoted exclusively to human rights concerns in March 1991, and agreed to receive another later this year. They also agreed to receive human rights delegations to be sent by the governments of France and Australia. In addition, they have taken a number of modest but positive steps to improve the human rights situation in China.

- Martial law was lifted in Beijing in January 1990 and in Lhasa four months later. No part of China is currently subject to martial law.
- Most of those detained after the Tiananmen tragedy were released by the end of 1989. Chinese authorities announced the release of nearly 1000 more detainees in 1990, and about 70 have been released so far in 1991. Officials claim that only 21 still await trial detention in Beijing, and at least one of these -- labor leader Han Dongfang -- has been released for medical treatment.
- While at least 30 persons have been convicted on political charges since the beginning of the year, the sentences meted out to them were generally less severe than those imposed on similar charges in previous years. Those released without further punishment included prominent dissidents such as essayist Liu Xiaobo, journalist Zhang Weiguo, playwright Wang Peigong, and legal scholar Chen Xiaoping.
- Leading dissident Fang Lizhi and his wife, who had obtained refuge in the U.S. Embassy in Beijing for over a year, were allowed to leave China in June 1990, and are now at Princeton.
- Most investigations of those involved in the 1989 protests have ended, and most of our Chinese contacts report that the oppressive atmosphere of 1989 has lifted significantly.
- The Chinese have ceased the most odious forms of harassment of Chinese students and scholars in the U.S.; harassment was a serious problem in 1989 and early 1990.
- Relatives of many, though not all, overseas dissidents have been allowed to leave China and join them abroad. In some

of the remaining cases that we have raised with Chinese officials, passports have subsequently been issued.

- Several released dissidents, including Tiananmen hunger striker Gao Xin and former Arizona State student Yang Wei, have been allowed to leave the country.
- Chinese authorities have undertaken to stop the export to the U.S. of products made in Chinese prisons. We will continue to monitor this situation closely, but it appears that the Chinese government is taking increasingly specific steps to enforce their prohibition on export of these products.
- In response to concerns expressed by Administration officials and Members of Congress, the Chinese have provided useful new information on the status of persons reported detained for religious activities.
- Economic reforms have resumed, in some cases matching or exceeding levels reached before 1989. Some limited political reforms, in important but relatively noncontroversial areas such as the personnel system, have continued. An Administrative Procedure Law that became effective in October 1990 for the first time enables Chinese citizens to sue abusive officials.

There are indications that further progress may be in the offing. We are continuing to press the Chinese government to release all remaining detainees, to commute the sentences of those nonviolent dissidents already convicted, and to allow the departure of the remaining relatives of overseas dissidents who wish to leave. We are hopeful that a combination of dialogue and specifically targeted pressure will lead to further movement on these and other remaining issues of concern. And in the longer term, we are confident that the momentum toward greater freedom and democratization in China, built up during the decade of reforms and dramatically reflected in the 1989 demonstrations, will prove irreversible.

PART II: ADMINISTRATION'S ACTIONS WITH RESPECT TO PROLIFERATION CONCERNS

The United States is engaged in a high-level dialogue with the Chinese that began early in our relationship. Looking at the broad trends in China's nonproliferation policy since normalization in 1979, it is clear that our dialogue has paid off in important areas, demonstrated by China's evolution toward international consensus on nonproliferation in areas of great importance to us. For example, China, which once held an antagonistic view of multilateral controls on nuclear exports, joined the IAEA in 1984 and sent observers to the Nuclear Nonproliferation Treaty Review Conference in 1990.

Middle East/South Asia

China's support for the Middle East arms control initiative is another case in point. China's participation in the initiative is a positive step that will strengthen international nonproliferation efforts and indicates China's resolve to contribute to efforts to attain stability in the Middle East. In addition, China's willingness to participate in multilateral efforts to reduce tension in South Asia will be crucial to establishing stability in that volatile region.

Moreover, we have seen Chinese arms sales restraint in some areas where we have vital interests. For example, to the best of our knowledge, apart from the 1987/88 sale of missiles to Saudi Arabia, China has not delivered medium-range missiles to the Middle East. It is clear that in other specific cases China has taken international concerns into account and declined proposed missile exports to prospective buyers.

Underscoring Our Concerns

It is because serious concerns remain that we want to maintain a constructive nonproliferation dialogue with Beijing. We do not intend to ignore current problems, but isolating China by dismantling the framework for our relations is not the way to advance our nonproliferation objectives.

We have the means available to underscore our concerns where there are differences in our approaches to nonproliferation and we have used these legislative and executive branch tools. For example, we have imposed trade sanctions mandated by the National Defense Authorization Act on Chinese entities involved in missile-related activities. We have also announced the Administration's decision that, pending progress toward our nonproliferation objectives, we will not license high speed computers and will not issue further waivers of legislative restrictions on satellite exports. These new sanctions have been imposed in addition to the existing sanctions announced immediately following the June 1989 assault on Tiananmen and amplified by Congress in the Department of State Authorization

Act for FY 1990-1991. Moreover, we have not certified China under the bilateral agreement for nuclear cooperation that took effect in 1985.

Our policy mix of sanctions and cooperation at any given time is necessarily dependent on Chinese behavior. We are encouraged by China's indication in June that it is reviewing its policies with respect to Missile Technology Control Regime (MTCR) and the NPT. We seek China's adherence to the NPT and the MTCR guidelines and will encourage the Chinese to take concrete steps toward adherence to the key multilateral standards for international behavior established by these institutions. The Administration will continue to use the legislative authority that already exists and will take resolute action if the Chinese do not address favorably our nonproliferation concerns.

PART III: TRADE AND ECONOMIC ISSUES

The Administration is committed to achieving with China the same goals that have guided our trade policy with all other countries. We seek open markets and the opportunity for U.S. firms and their products to compete on fair and equal terms. To achieve these goals, and realize the principles of equality, mutual benefit and non-discrimination set forth in the U.S.-China Bilateral Trade Agreement, this Administration has pursued a policy of negotiation and engagement on trade issues with China. In particular, the Administration has sought to improve U.S. access to China's marketplace; to bolster Chinese protection of intellectual property; to end fraudulent practices by Chinese textile exporters using false country of origin declarations; and, to induce Beijing to undertake the economic and trade reforms required for membership in the GATT.

Reciprocal MFN tariff treatment underpins our ability to work constructively with the PRC. China's desire to retain access to the U.S. market has enabled us to engage Chinese leaders even during periods of tension. We believe that discontinuing MFN, or attaching conditions to its renewal, would cause serious harm to our trade interests and erode our ability to influence China's behavior on key trade issues.

The Past Decade of Bilateral Trade Relations

After decades of adhering to an import-substitution strategy that focused on minimizing China's reliance on outside sources of machinery and equipment, China began in the 1980's to seek outside sources of these goods. It also has increasingly drawn on foreign technology, expertise, and funds by actively encouraging joint ventures.

China's opening to the outside world has helped transform its economy, bolstering reform-oriented sectors that are not directly controlled by the central government. For example, the state sector now produces just over half of China's industrial output; in 1978, its share was 78 percent. China's dynamic rural industries, which are privately and collectively owned, have burgeoned. There are 30,000 foreign-invested ventures now in China, with a total contracted value of \$40 billion. The impact of China's open door has been particularly pronounced in the southern and coastal provinces, where 90 percent of the foreign investment and more than three-fourths of China's trade activities are located. This region, in turn, has become the primary engine of economic reform in China largely as a result of the introduction of market concepts to Chinese employees of joint ventures and to citizens engaging in commercial exchanges with the West. The economic autonomy fostered by this interaction contributes to increased political and even individual self-determination.

The United States has been a vital partner in this transformation. Following Congressional approval of the bilateral trade agreement, the United States and China established formal trade relations and reciprocally granted most-favored-nation (MFN) status in 1980. Growth in our commercial ties has helped to change China and to bring it into the global trading system. Since the resumption of normal trade relations, U.S.-China two-way trade has increased almost 770 percent, from \$2.3 billion in 1979 to over \$20 billion last year.

- We are now China's second-largest trading partner and its largest export market.
- China is our tenth-largest trade partner, up from fifteenth in 1981.
- Over 1,000 U.S. firms have invested more than \$4 billion in China and another \$5 billion in Hong Kong related primarily to trade with the PRC.
- In 1990, the United States exported \$4.8 billion worth of goods to China, including:
 - \$749 million worth of aircraft
 - \$544 million worth of fertilizer
 - \$512 million worth of grain
 - \$281 million worth of cotton yarn and fabric
 - \$273 million worth of chemicals
 - \$264 million worth of electric machinery
 - \$238 million worth of wood and wood pulp
 - \$227 million worth of scientific instruments.

Commercial relations with the United States have exerted positive influences on China's business and economic practices since 1980. China has shifted away from total reliance on a strongly centralized economy, shown greater tolerance for experimentation with market mechanisms to regulate its domestic economy, and decentralized and liberalized its foreign trade practices.

Regression in China's Trade Policies

China's opening to the outside world has not been smooth. Over the past decade, attempts to accelerate the implementation of market-oriented reforms have been followed by Beijing's recentralization of control, as concern about the country's ballooning trade deficit led Beijing to step in to regain some of the trade authority it had relinquished.

Moreover, throughout the period since the normalization of trade relations and the granting of reciprocal most-favored-nation trading status in 1980, China's web of barriers to imports has made it difficult for many U.S. exporters to gain access to the Chinese market. U.S. firms have also had difficulty securing protection for their intellectual property.

U.S. trade negotiators have long been engaged with the Chinese Government, both in bilateral negotiations and in multilateral consultations at the GATT held to review China's application for membership. We have sought to ensure that bilateral commercial relations develop in accord with the principles that underlie our bilateral trade agreement: equality; mutual benefit; and nondiscrimination. From 1979 through 1987, Chinese authorities made some progress in reducing nontariff barriers to imports, in improving transparency, and in protecting the intellectual property of foreigners.

This trend has been reversed over the last three years.

- Since 1988, Chinese trade policies and practices have become more protectionist, nontariff barriers to imports have proliferated, and the trade system has become less transparent. These policies undoubtedly contributed to a 17 percent decline in U.S. sales to China in 1990. China was the only major foreign market for U.S. goods and services in which our exports declined in 1990.
- Despite intensive bilateral negotiations with Chinese authorities since the USTR in 1989 placed China on the "priority watch list" of countries providing inadequate intellectual property protection--including three rounds of meetings over the past five months--China has failed to live up to the commitments contained in the bilateral Memorandum of Understanding (MOU) signed in May 1989.

At the same time, other problems have developed in our bilateral trade relationship. For example, to bypass U.S. textile and apparel quotas, Chinese exporters have increasingly resorted to shipping these products to the United States via third countries using false invoices and counterfeit visas. Also of concern to us has been the apparent lapse in China's commitment to economic and trade reforms that would bring the country in line with the GATT's free-trade principles. China's reassertion of central control over the past few years has called into question its willingness and ability to undertake the obligations that would be required of China as a contracting party to the GATT.

Steps the U.S. Government Has Taken and Will Take to Address Bilateral Trade Problems

In six key areas of our bilateral trade and economic relations, the Administration has taken steps to resolve trade problems. We are prepared to do more.

On Market Access

- Beginning in the fall of 1990, the Administration resumed sub-cabinet level meetings with the Chinese, that had been suspended since June 1989, to secure Chinese actions to reverse the growing list of new protectionist measures.

- In April 1991, the Administration formally set in motion a market access initiative that continued with the visit to Beijing, in mid-June, of an interagency delegation to discuss market access issues. In meetings with senior Chinese officials, U.S. Government officials raised nine types of market access barriers, including: the lack of transparency in rules and regulations; the expansion of import licensing requirements; the use of import substitution policies; the proliferation of import bans and quotas; the growth of standards, testing, and certification requirements, including discriminatory "quality standards" procedures for imports; the high level of many import tariffs; the unnecessary use of certain phytosanitary regulations; the uncertainties regarding government procurement and tendering regulations; and the lack of information regarding China's major development projects.

- The Administration has proposed holding another round of market access consultations in August 1991. If that round of negotiations fails to yield substantial commitments from the Chinese authorities to dismantle market access barriers, the Administration will self-initiate Section 301 action to address those barriers the removal of which offers the most potential for achieving U.S. trade policy objectives and increasing U.S. exports.

On Intellectual Property Protection

- On April 26, 1991, USTR identified the PRC as a priority foreign country that denies adequate and effective protection of intellectual property rights. Accordingly, on May 26, 1991 USTR initiated a Special Section 301 investigation on the basis of four problem areas: (1) inadequate copyright protection, (2) inadequate patent protection, (3) inadequate trade secret protection and (4) ineffective enforcement of trademarks. Consultations with the Chinese are ongoing. The first round of consultations under the Section 301 investigation occurred in mid-June and a second has been proposed for August.

- The deadline for making a determination under Section 301 is November 26, 1991. This may be extended for three months if China is making substantial progress in drafting or implementing measures that will provide adequate and effective protection of U.S. intellectual property rights. At that time, the USTR must determine whether the acts, policies and practices of the PRC are actionable under Section 301 and what retaliatory action, if any, is appropriate.

- If the consultations fail to produce adequate and effective protection of intellectual property rights, the Administration will take retaliatory action.

On Textile Transhipments

- The U.S. Customs Service has been vigilant in documenting cases of Chinese textile transhipments over the past year.
- In August 1990, USTR held consultations with Chinese authorities on the transhipment issue. Additional consultations took place in November 1990, March 1991, and May 1991.
- The U.S. Government "charged" China's quotas for goods that were sent to the United States under false country of origin declarations valued at over \$85 million.
- China has begun to take actions to curtail textile fraud since the December charges were made. For example, it issued regulations prohibiting reexports through a third country to countries that have signed textile agreements with China. Further, the Chinese Government has issued provisions for the punishment of those who violate the regulations.
- The Administration has prepared more charges valued at about \$14 million that we anticipate will be levied after consultations with China next month.
- The Administration will increase the number of U.S. Customs officials dedicated to investigating circumvention.
- If transhipment persists, we will be prepared to take additional action against China.

On Forced Labor

- The importation of goods produced with forced, convict or indentured labor is prohibited by 19 USC Section 1307, which also directs the Secretary of the Treasury to prescribe regulations for enforcement of the provision. The Secretary of the Treasury, under 19 CFR Section 12.42, has delegated to the Commissioner of Customs, authority to determine that a class of goods is the product of forced labor and exclude those goods.
- Customs has been investigating imports alleged to be the product of forced labor in China. Customs has interviewed emigres about forced labor practices in China. Customs is also analyzing import samples to determine if they match the descriptions provided by the emigres and others. Additional special agents have

been detailed to Hong Kong to assist in the investigation.

- Although the letter from Senator Baucus and fourteen co-signers did not specifically address the issue of prison labor imports, appropriate action is called for to fulfill the intent of existing law. The Administration therefore proposes to negotiate a memorandum of understanding with China on procedures for the prompt investigation of allegations that specific products exports to the U.S. are being produced by prison labor.
- Pending negotiation of the MOU, Customs will temporarily embargo specific products from China when there is reasonable indication that they are made by prison labor. Embargoes will be lifted only after the Chinese Government or the Chinese exporter provides credible evidence that the products are not produced by prison labor.

Multilateral Lending to China

- The G-7 consensus, led by the United States, was successful in prohibiting all MDB lending to China from June 1989 to February 1990 in response to the international outcry against the crackdown by the Chinese authorities at Tiananmen Square.
- From February 1990 to July 1990, the G-7 consensus supported a gradual resumption of World Bank lending to China for projects that clearly met basic human needs (BHN). The consensus held firm and actively prohibited other loans from Board consideration. Only five loans (totalling \$590 million) were approved in WBFY 1990. This is substantially less than pre-Tiananmen Square levels of World Bank commitments to China, which were \$1.4 billion in WBFY 1988 and \$1.3 billion in WBFY 1989.
- At the Houston Summit in July 1990, several G-7 countries decided that China's long-term development needs argued for lending outside the BHN limits favored by the United States. Accordingly, the G-7 Houston Summit Declaration of July 1990 on MDB lending to China expanded the boundaries of permitted MDB lending to China to include loans which were environmentally beneficial or which supported market-oriented economic reform. Only BHN loans were considered by the World Bank Board until December 4, 1990 when the market oriented economic reform loan for Rural Industrial Technology was approved by the Board. On November 29, 1990, the ADB approved its first loan to China since Tiananmen Square, Agricultural Bank Project, which the U.S. did not support. Despite the approval of infrastructure project loans by the World Bank and the

Asian Development Bank, the U.S. has and will continue to withhold support on all loans that do not meet BHN criteria.

On GATT Accession

- Since China applied for GATT membership in July 1986, the United States has been a leading participant in the collective efforts of major GATT Contracting Parties to develop terms for China's GATT participation that will support the objectives of the GATT and will influence Chinese Government policies to become, over time, more compatible with the GATT framework for world trade.
- U.S. and other major GATT contracting parties' concerns about China's ability and willingness to live up to GATT obligations, particularly since June 1989, have stalled progress in the Working Party established to consider China's application for membership in the GATT.
- The Administration intends to continue to press Beijing to undertake trade and economic reforms so that its GATT application can advance and its trade practices be brought under GATT disciplines.
- At the same time, the Administration will begin to work actively with other GATT members to resolve in a favorable manner the issues relating to Taiwan's GATT accession. U.S. support for Taiwan's accession as a customs territory would be consistent both with GATT legal criteria and the "one-China" policy which acknowledges the Chinese position and has been adhered to by successive U.S. administrations.
- Taiwan's GATT accession would yield substantial trade and commercial benefits to the United States and to the international trading system.
 - Taiwan has indicated that it is prepared to accede to the GATT as a developed economy, to bind virtually all its tariffs, and to join the major non-tariff measure GATT codes.

The Importance of MFN

As highlighted above, the Administration is aggressively seeking to resolve outstanding bilateral trade issues with the PRC. MFN underpins our ability to work constructively with the PRC. We believe that discontinuing MFN, or attaching conditions to its renewal, would cause serious harm to our trade interests, and would render futile pursuit of the initiatives outlined above.

It would reduce our leverage in market-access, intellectual property rights protection, and other trade-related negotiations. China's desire to retain access to the U.S. market has enabled us

to engage Chinese leaders in consultations on bilateral and multilateral issues even during periods of tension. Because China is not a GATT member and not bound by GATT trade disciplines, it is especially important to have many levers that enable us to engage the Chinese on trade issues.

It would hurt U.S. exporters. If the United States rescinds China's MFN trading status, China will not only discontinue MFN tariff treatment for the United States, but would likely cease purchasing billions of dollars of U.S. wheat, aircraft, fertilizer, cotton yarn and fabric, wood and wood pulp, electric machinery, scientific equipment, and chemicals. Foreign competitors, whose goods would be subject to lower tariffs, would be quick to exploit our departure. Lost shares of China's market would not easily be regained even if MFN were restored at some future date.

It would hurt U.S. consumers. Tariffs on the 25 most important U.S. imports from China would rise from the present average tariff rate of 8.8 percent to an average rate of 50.5 percent. These increases would mean sharply higher prices for lower-end Chinese goods. The costs to U.S. consumers would be largely borne by poorer Americans, who are primary consumers of low-cost Chinese products.

It would damage America's reputation as a reliable trade partner. Our trade competitors will not join us in denying MFN status to China. Other Chinese trade partners, especially in Asia, urge that China's MFN status be retained.

It would hurt investors, businesses, and workers in Hong Kong. Loss of MFN would impede China's integration into the regional economy, a development crucial to regional stability particularly as we near the 1997 deadline for Hong Kong's reversion to Chinese sovereignty. It could cost over 43,000 jobs in Hong Kong and result in direct revenue losses of approximately \$1.2 billion dollars. Hong Kong's GDP growth could be curtailed by as much as two percent.

It would set back efforts to bring about meaningful economic reform in China. A disproportionate burden of the MFN denial would fall on the primary engine of economic reform in China--the economies of the southern and coastal provinces. In Guangdong province, for example, 40 percent of industrial output is produced for export, half of which goes to the United States. Sectors that fall outside of the direct control of the central government have been especially important to China's development as an exporter; one-third of China's exports currently come from rural (individual and collectively owned) industries and from foreign-invested ventures. The foreign ties these provinces and non-state-owned factories developed with the outside world prior to Beijing's reassertion of central control in mid-1989 enabled these provinces to weather the austerity program; without these foreign markets, Beijing's grip would have been all the tighter. As Beijing's influence over the regions and sectors most closely integrated into the global economy has diminished, these regions

and sectors have become increasingly sensitive to global economic conditions. Revocation of China's MFN trading status would cause unemployment to rise and factory losses to mount in export-producing regions.

Conclusion

Those who engineered the violence in China in June 1989 are unlikely to bear the economic costs associated with the denial of MFN. Instead, those who suffer would be American businesses and their employees, American consumers, and the people of Hong Kong and the progressive areas of China.

China's opening to the outside world over the past decade has accelerated growth in the non-state sectors of the economy; resulted in strong links between China's coastal regions and the global economy that have enabled this reformist region to weather Beijing's periodic efforts to reimpose central government control over economic activity; and introduced market concepts to a generation of Chinese managers involved in joint ventures, trade negotiations, and training in the West. For this process to continue, China's most-favored-nation treatment in the United States is essential.



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

July 15, 1991
(Senate)

O'Edc
Elizabeth



STATEMENT OF ADMINISTRATION POLICY

(THIS STATEMENT HAS BEEN COORDINATED BY OMB WITH THE CONCERNED AGENCIES.)

S.J.Res. 153 - Resolution of Disapproval of the President's
Decision to Extend MFN to China
(Cranston (D) California)

S. 1367 - United States-China Act of 1991
(Mitchell (D) Maine and 24 others)

The Administration strongly opposes S.J.Res. 153, which would deny China most-favored-nation (MFN) trade status, and S. 1367, which would place additional conditions on MFN renewal. If either of these bills is presented to the President, his senior advisors will recommend a veto.

The President extended China's MFN waiver because he determined that China met the legal requirements under the Jackson-Vanik amendment and that continuing MFN would serve broad U.S. economic and foreign policy interests and promote reform in China. Over the past year, China has continued its relatively open emigration policy. Extension of MFN substantially promotes U.S. freedom of emigration and travel objectives, and its withdrawal would place at risk the substantial gains already achieved in these areas.

Extension of MFN is also important for promoting reform in China. Foreign trade keeps China open to the outside world and supports the economic forces that are driving domestic political and social change and encouraging a loosening of state control and more personal freedom. Millions of Chinese depend on a healthy commercial relationship to justify business and social contacts with the United States. MFN withdrawal would hurt all Chinese, but would hurt most those Chinese, particularly in the market-oriented coastal provinces, who have the greatest stake in economic reform.

A fundamental pillar of our relationship with the Chinese people, MFN is essential if we are to stay engaged with China on a broad range of issues, including human rights, nonproliferation, prison labor exports, and trade. Eliminating MFN would seriously erode our ability to influence Chinese behavior on these issues. It would also hurt U.S. exporters and consumers, and undermine confidence in Hong Kong where the United States has substantial economic interests.

Conditional renewal is not acceptable because it would make China less likely to respond to U.S. concerns. Hardline Chinese leaders would claim that national honor and sovereignty preclude any concessions to the United States. Imposing new conditions for renewal would, in effect, hold our single most powerful instrument for influencing China -- trade and the openness which it brings -- hostage to the reactions of the Chinese Government.

Where particular issues are unresolved and the Chinese are not forthcoming, the President has the tools necessary to pursue U.S. interests in a targeted fashion. MFN's withdrawal is the wrong tool because of its indiscriminate impact and adverse effect on all Chinese, particularly those who continue to seek reform. The Administration believes that MFN should be renewed unconditionally now on its own merits, as the most effective means for influencing China's behavior on a range of U.S. interests.

* * * * *

(Not to be Distributed Outside Executive Office of the President)

This draft position was prepared by LRD (Rooney) in consultation with IAD (DuSault/Dorsey), BASD (Lind), GC (Rettman), State (Davis), USTR (Janow), Commerce (Dalmut), Treasury (Levy), NSC (Paal), Agriculture (Vial), CEA (Staiger), and OCA (Korfonta). This SAP, which is virtually identical to one used for the House, was also provided to Defense, Labor, Justice, and WH Counsel which were unable to respond within the deadline.

Background

Section 402 of the Trade Act of 1974 (the "Jackson-Vanik amendment") stipulates three objectives relating to freedom of emigration which must be met before a non-market economy country may be granted most-favored-nation (MFN) trade status. (MFN grants a country low tariffs on exports to the United States.) Section 402 also authorizes the President to waive these freedom of emigration requirements annually, if he determines that so doing will substantially promote the objectives of freedom of emigration. Title IV of the Trade Act includes congressional procedures for disapproving a Presidential extension of MFN, which require Congressional adoption of a joint resolution of disapproval within 60 days of the beginning of the period for which MFN is being granted. Additional time is provided for congressional action in the event of a Presidential veto.

The People's Republic of China has received MFN status through the annual waiver process since 1980. On May 29, 1991, President Bush notified Congress of his decision to waive the Jackson-Vanik

freedom of emigration requirements and extend MFN trade treatment to products from China for an additional year which begins July 3, 1991.

Administration Position to Date

This position is virtually identical to the one provided to the House during its consideration of H.J.Res 263 and H.R. 2212, which disapprove and condition China MFN trade status, respectively. On July 10, 1991, the House passed H.J.Res. 263 and H.R. 2212 by 223-204 and 313-112, respectively.

Provisions of S.J.Res. 153

S.J.Res. 153 disapproves the President's decision to renew MFN status for China. This joint resolution is identical to House-passed H.J.Res. 263.

Provisions of S. 1367

S. 1367, which was reported without recommendation by the Senate Finance Committee, includes many of the same conditions as the House-passed conditional MFN bill (H.R. 2212), but the bills are not identical.

S. 1367 provides that MFN status may not be extended to China for the 12-month period beginning July 3, 1992, unless the President includes in his report to Congress, required by section 402 of the Trade Act, that China has:

- accounted for those citizens who were detained, accused, or sentenced because of pro-democracy protests leading up to, during, and after the 1989 crackdown in Tiananmen Square;
- released citizens imprisoned because of Tiananmen Square protests;
- ceased exporting goods produced using forced labor;
- ceased supplying arms and military assistance to the Khmer Rouge; and
- is adhering to the Joint Declaration on Hong Kong, which lays out the terms for the transfer of the territory from Britain to China.

In addition, the President would also be required to report that China has made "significant progress" in specific areas, including:

- fulfilling its commitment to engage in high-level discussions on human rights issues;
- taking appropriate action to prevent gross violations of human rights and fundamental freedoms in China and Tibet, including an end to religious persecution and removing restrictions on freedom of the press and Voice of America broadcasts;
- ending intimidation and harassment of Chinese citizens in the United States;
- granting access by humanitarian and human rights groups to prisoners, trials, and places of detention;
- providing adequate protection of U.S. patents and copyrights, and other intellectual property rights;
- providing greater access for U.S. exports to China by lowering tariffs and other trade barriers; and
- adhering to limits and controls on nuclear, chemical, and biological arms proliferation.

S. 1367 also requires that, 15 days after enactment, MFN status would be withdrawn unless the President certifies to Congress that China has not transferred certain ballistic missiles or launchers to Syria, Iran, or Pakistan. In addition, MFN would be withdrawn, if the President determines that missiles or launchers were transferred subsequent to the date of enactment.

Scoring for the Purpose of Pay-As-You-Go and the Caps

According to IAD (DuSault/Dorsey), BASD (Lind), and GC (Rettman), S.J.Res. 153 is subject to the pay-as-you-go requirement of the Omnibus Budget Reconciliation Act of 1990. Specifically, if MFN status is terminated significantly higher duties would be imposed on Chinese imports, which would increase revenue on a reduced level of imports. IAD estimates increased revenue for FY 1992 of \$47 million, and no effect in the outyears. S. 1367 is not subject to the pay-as-you-go requirement of the Omnibus Budget Reconciliation Act of 1990 because continuation of MFN status in July 1992 is dependent upon the President's reporting to Congress that certain conditions have been met.

CBO is estimating increased revenue of \$435 million for FY 1992 and zero for the outyears for S.J.Res. 153 and no paygo effect for S. 1367. CBO and OMB's estimates are based on elasticity

factors which incorporate the effects of imports from all sources. In addition, CBO estimates additional revenue for imports from other non-Chinese sources. OMB and CEA staff believe that, given the nature of the elasticity estimates, revenue for these additional non-Chinese sources is already accounted for and its inclusion is duplicative.

LEGISLATIVE REFERENCE DIVISION DRAFT
7/11/91 -- 5:00

THE WHITE HOUSE
Office of Cabinet Affairs
Routing Slip

From: Olin Wethington Date: 7/22/51

| | <u>Sequence To</u> | <u>Has Seen</u> | <u>Disposition</u> |
|--|--------------------|-----------------|--------------------|
| Williamson ^{Lutty} | <u>1</u> | <u>EC</u> | <u>R</u> |
| Blumenthal | _____ | _____ | _____ |
| Wethington | _____ | _____ | _____ |
| Porter | _____ | _____ | _____ |
| Holiday | <u>2</u> | Seen | <u>I</u> |
| Watkins | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ |

A=Action I=Information R=Review D=Dispatch

cc: Adair Blumenthal Buchholz Casse Farrar
 Fitzhenry Gunn Holiday Lefkowitz
 Porter Schall Sechler Wethington Williamson

Comments:

THE WHITE HOUSE

WASHINGTON

July 19, 1991

Dear Senator Dole:

I appreciated receiving your views on the importance of renewing China's most-favored-nation (MFN) trade status while also seeking to achieve progress with the Chinese on issues of vital concern to the American people. We clearly share the same goals. We want to see China return to the path of reform, show greater respect for human rights, adhere to international norms on weapons sales, and practice fair trade. China should contribute to international stability and not detract from it.

You rightly note that withdrawing MFN would hurt not only Americans but also the people of Hong Kong and the millions in China who are working for progressive change. Continuing MFN is essential to protect American consumers and exporters, and to support the economic forces that have been driving reform in China for more than a decade. It is no accident that the process of reform accelerated with the increase in foreign businesses operating in that nation. Those who would end political and economic reform in China have the most to gain if MFN were withdrawn. It is the economic forces pressing for the loosening of state control and increased personal freedom that would suffer the most. Other losers would be the thousands of American workers and farmers who together produced in 1990 almost \$5 billion in exports to China.

Since we started the process of normalizing contacts with China in the 1970s, there has been strong bipartisan support for the U.S.-China relationship. Building on the three U.S.-China communiqués, U.S. interaction with the government and people of China has produced demonstrable progress. That interaction must continue despite the recent severe setbacks. Nevertheless, I support the view that strong measures are needed to address our concerns in China and have not hesitated to use them in a targeted fashion. To underscore our deep dismay about human rights violations, I have kept in place a number of sanctions since the Tiananmen Square crackdown which have affected arms sales, high-level contacts, U.S. economic programs and U.S. support for multilateral development bank lending to China.

The U.S. is currently the only nation maintaining its Tiananmen sanctions and refusing to normalize relations until China makes substantial progress on human rights. For example, while all our allies and other World Bank members have supported virtually all of the last sixteen World Bank loans to China, we have declined

to support seven because the loans would not serve basic human needs.

At the London Summit, we raised China's human rights practices with our G-7 allies and encouraged them to continue to stress to China's leaders, as we have repeatedly, the importance that democratic governments attach to human rights. We made clear that the U.S. will continue its policy of supporting only those multilateral development loans for China that serve basic human needs (BHN), and our view that any non-BHN lending to China help to promote market-oriented economic reform.

To advance our nonproliferation objectives, I recently authorized a number of steps aimed at engaging the Chinese on their weapons transfer policies and making clear our dissatisfaction with transfers that contribute to regional instability. The Under Secretary of State for International Security Affairs recently traveled to Beijing for a detailed discussion of nonproliferation issues, including our specific concerns about Chinese exports. He pressed for China's adherence to the Nuclear Nonproliferation Treaty and the Missile Technology Control Regime, actions I called for in my commencement speech at Yale University on May 27. We are pleased with the constructive role China played in the July 8-9 Middle East arms control talks in Paris. The Chinese endorsed all the key objectives of my Middle East arms control initiative (such as efforts to freeze and ultimately eliminate surface-to-surface missiles and block the production and acquisition of nuclear useable material). The Chinese also agreed to work rapidly in follow-on meetings to flesh out the broad agreements reached in Paris.

At the same time, I have also taken measures to emphasize to China that the U.S. is concerned about reports of destabilizing missile-related transfers. In April, I rejected requests for licenses to export satellite components for a Chinese communications project because of the involvement of Chinese companies in unacceptable missile equipment transfers. Just recently, I approved trade sanctions against two Chinese companies for that same reason. In addition, I directed that no further licenses of high-speed computers and no further exports of satellites to China be authorized until our concerns that China adhere to accepted international nonproliferation standards are satisfactorily addressed. The U.S. will be coordinating with other countries in order that these measures not be undercut. Our experience has demonstrated that such consultations will lead to effective, multilateral technology transfer restrictions.

I have also instructed U.S. agencies to press vigorously our concerns about Chinese unfair trading practices. In April, I directed the U.S. Trade Representative to identify China as a priority foreign country under the Special 301 provisions of the Trade Act for failing to protect U.S. intellectual property

rights. If China does not make real progress during the 301 investigation, trade action will follow. Beyond intellectual property protection, my Administration has invited senior Chinese trade officials to Washington in August for continuation of consultations begun in June regarding access for U.S. products to the Chinese market. If these talks fail to produce Chinese commitments to take substantial measures to improve market access, the Administration will self-initiate further action under Section 301 of our trade laws.

We are strictly enforcing the terms of our textile agreement with China and have already made charges against China's quota because of illegal textile shipments through third countries totalling approximately \$85 million so far. Following consultations in July, we expect to make additional charges. If China does not exert effective control over these illegal shipments, we are prepared to take additional action against China.

Charges that China exports goods produced with prison labor are a matter of serious concern. The Customs Service is investigating these charges. In addition, we have obtained a firm high-level commitment to prevent the sale of prison labor products to the United States. We will continue to monitor China's behavior in this area closely and will strictly enforce relevant legislation concerning prison labor exports. In particular, I am ordering the following additional measures: The Department of State will seek to negotiate a memorandum of understanding with China on procedures for the prompt investigation of allegations that specific imports from China were produced by prison labor. Pending negotiation of this agreement, the U.S. Customs Service will deny entry to products imported from China when there is reasonable indication that the products were made by prison labor. The denial will continue until the Chinese Government or the Chinese exporter provides credible evidence that the products were not produced by prison labor.

I am also instructing the U.S. Customs Service to identify an office to receive information on prison labor exports and establish procedures for the prompt investigation of reports of prison labor exports from interested parties. Additional customs officials will be directed to identify prison labor exports and aid in uncovering illegal textile transshipments.

Although it is not directly related to China's MFN status, I share your interest in Taiwan's accession to the GATT. As a major trading economy, Taiwan can make an important contribution to the global trade system through responsible GATT participation. The U.S. has a firm position of supporting the accession of Taiwan on terms acceptable to GATT contracting parties. The United States will begin to work actively with other contracting parties to resolve in a favorable manner the issues relating to Taiwan's GATT accession. Because China, our

tenth largest trading partner, could also make an important contribution to the global trading system, I will seek to have the Chinese Government take steps on trade reform so that China's GATT application can advance and its trade practices can be brought under GATT disciplines through the Working Party formed for China in 1987. U.S. support for Taiwan's accession to GATT as a customs territory should in no way be interpreted as a departure from the long-standing policy of five administrations which acknowledges the Chinese position that there is only one China, and that Taiwan is part of China.

In sum, therefore, I am prepared to address the concerns you and your colleagues have identified, and I am doing so. But discontinuing MFN, or attaching conditions to its renewal, would cause serious harm to American interests and would render futile pursuit of the initiatives I have outlined, which are discussed in greater detail in the attachments. Working together, I believe we will best protect America's interests by remaining engaged with China and the Chinese people.

Sincerely,



P.S. At the recently concluded G-7 Summit in London, the leaders of these Western Democracies all urged renewal of MFN.

Attachments:

- Part I - Human Rights
- Part II - Nonproliferation
- Part III - Trade and Economic Issues

The Honorable Robert J. Dole
United States Senate
Washington, D.C. 20510

PART I: HUMAN RIGHTS

Human rights concerns have been at the heart of our relationship with the PRC since the tragic events of June 1989. Every high-level meeting since that time has at least touched on human rights issues, and several -- such as the December 1990 visit to China by Assistant Secretary Schifter -- have been devoted exclusively to them. We have consistently stressed to the Chinese leadership that there can be no return to the kind of relationship we enjoyed before 1989 without substantial improvements in China's human rights practices.

Our overall approach on human rights issues has consisted of:

Public expression of concern

- President Bush condemned the brutal suppression of demonstrations in Tiananmen Square in June 1989, the first world leader to do so. He declared May 13, 1990 a National Day in support of Freedom and Human Rights in commemoration of the 1989 demonstrations, and issued another statement to mark the anniversary of the crackdown in 1991.
- In our human rights reports for 1989 and 1990, we were fair but hard-hitting, and as accurate as available information would allow. These reports have drawn high praise from human rights groups, and harsh condemnations from the Chinese government.
- The State Department issued a statement on January 9, 1991 condemning the trials of nonviolent dissidents.
- In April 1991 the President met the Dalai Lama at the White House to demonstrate our respect for His Holiness' nonviolent approach to conflict resolution and our concern for human rights problems in Tibet.

Suspension of bilateral programs

On June 6 and June 20, 1989, the President announced the suspension of a number of bilateral programs and changes in U.S. approach to multilateral issues until the human rights climate in China improved. Those suspensions generally remain in effect.

- A multitude of high-level exchange visits that would normally have taken place since 1989 have been canceled. Only a very limited number of visits at and above Assistant Secretary level have been approved on a case-by-case basis, and only when they addressed issues of key concern to the United States, e.g., like human rights, nonproliferation, unfair trade practices, and narcotics.
- Military exchange visits have been suspended completely.

- Under Secretary Kimmitt in May 1991 reiterated many of the points made by Assistant Secretary Schifter, and called on the Chinese government to declare an amnesty for all those imprisoned for nonviolent political activities. He also urged the Chinese to implement effectively their claimed prohibition on export of prison labor products.

Results of actions

Most importantly, the Chinese government has acknowledged the legitimacy of human rights as a subject of bilateral discussion, both with us and with other concerned governments. They received a Congressional delegation devoted exclusively to human rights concerns in March 1991, and agreed to receive another later this year. They also agreed to receive human rights delegations to be sent by the governments of France and Australia. In addition, they have taken a number of modest but positive steps to improve the human rights situation in China.

- Martial law was lifted in Beijing in January 1990 and in Lhasa four months later. No part of China is currently subject to martial law.
- Most of those detained after the Tiananmen tragedy were released by the end of 1989. Chinese authorities announced the release of nearly 1000 more detainees in 1990, and about 70 have been released so far in 1991. Officials claim that only 21 still await trial detention in Beijing, and at least one of these -- labor leader Han Dongfang -- has been released for medical treatment.
- While at least 30 persons have been convicted on political charges since the beginning of the year, the sentences meted out to them were generally less severe than those imposed on similar charges in previous years. Those released without further punishment included prominent dissidents such as essayist Liu Xiaobo, journalist Zhang Weiguo, playwright Wang Peigong, and legal scholar Chen Xiaoping.
- Leading dissident Fang Lizhi and his wife, who had obtained refuge in the U.S. Embassy in Beijing for over a year, were allowed to leave China in June 1990, and are now at Princeton.
- Most investigations of those involved in the 1989 protests have ended, and most of our Chinese contacts report that the oppressive atmosphere of 1989 has lifted significantly.
- The Chinese have ceased the most odious forms of harassment of Chinese students and scholars in the U.S.; harassment was a serious problem in 1989 and early 1990.
- Relatives of many, though not all, overseas dissidents have been allowed to leave China and join them abroad. In some

- Work on several existing military equipment and technology projects has been suspended indefinitely.
- We have stopped the transfer of military or dual-use equipment or technology to Chinese military and security services.
- The U.S. sought to postpone all multilateral development bank loans to China from June 1989 to January 1990. Since then, we have supported only those loans that serve the basic human needs of the Chinese people.
- We have suspended grants, loans and insurance guarantees to China under the Trade and Development Program and OPIC.
- We have worked through COCOM to suspend planned liberalization of export controls to China.

Engagement in dialogue

Through the few high-level visits that have been authorized, and through regular diplomatic channels, we have engaged the Chinese government in an unprecedented continuing dialogue on a wide range of human rights issues.

- The Scowcroft-Eagleburger missions of July and December 1989 were devoted primarily to laying out our human rights concerns and suggesting steps the Chinese could take to address them.
- During Chinese Foreign Minister Qian's visit to Washington in November 1990, President Bush and Secretary Baker reiterated the need for progress on human rights, and stressed that human rights is a cornerstone of American foreign policy.
- Assistant Secretary Schifter visited China in December 1990, the first time our top human rights official has done so. In sixteen hours of intense discussions with senior Chinese officials, he spelled out in detail our human rights concerns in a wide range of areas including accounting of detainees, release of political prisoners, denial of due process and fair and open trials, treatment of prisoners, divergence of Chinese law from international standards, respect for freedom of religion, abusive implementation of family planning regulations, and human rights problems in Tibet. He delivered a list of 151 representative cases of reported political incarceration, and asked Chinese authorities to clarify the status of the cases and release those whose imprisonment violated international norms. He suggested changes in Chinese laws and judicial processes that would bring them into conformity with international standards.

of the remaining cases that we have raised with Chinese officials, passports have subsequently been issued.

- Several released dissidents, including Tiananmen hunger striker Gao Xin and former Arizona State student Yang Wei, have been allowed to leave the country.
- Chinese authorities have undertaken to stop the export to the U.S. of products made in Chinese prisons. We will continue to monitor this situation closely, but it appears that the Chinese government is taking increasingly specific steps to enforce their prohibition on export of these products.
- In response to concerns expressed by Administration officials and Members of Congress, the Chinese have provided useful new information on the status of persons reported detained for religious activities.
- Economic reforms have resumed, in some cases matching or exceeding levels reached before 1989. Some limited political reforms, in important but relatively noncontroversial areas such as the personnel system, have continued. An Administrative Procedure Law that became effective in October 1990 for the first time enables Chinese citizens to sue abusive officials.

There are indications that further progress may be in the offing. We are continuing to press the Chinese government to release all remaining detainees, to commute the sentences of those nonviolent dissidents already convicted, and to allow the departure of the remaining relatives of overseas dissidents who wish to leave. We are hopeful that a combination of dialogue and specifically targeted pressure will lead to further movement on these and other remaining issues of concern. And in the longer term, we are confident that the momentum toward greater freedom and democratization in China, built up during the decade of reforms and dramatically reflected in the 1989 demonstrations, will prove irreversible.

PART II: ADMINISTRATION'S ACTIONS WITH RESPECT TO PROLIFERATION CONCERNS

The United States is engaged in a high-level dialogue with the Chinese that began early in our relationship. Looking at the broad trends in China's nonproliferation policy since normalization in 1979, it is clear that our dialogue has paid off in important areas, demonstrated by China's evolution toward international consensus on nonproliferation in areas of great importance to us. For example, China, which once held an antagonistic view of multilateral controls on nuclear exports, joined the IAEA in 1984 and sent observers to the Nuclear Nonproliferation Treaty Review Conference in 1990.

Middle East/South Asia

China's support for the Middle East arms control initiative is another case in point. China's participation in the initiative is a positive step that will strengthen international nonproliferation efforts and indicates China's resolve to contribute to efforts to attain stability in the Middle East. In addition, China's willingness to participate in multilateral efforts to reduce tension in South Asia will be crucial to establishing stability in that volatile region.

Moreover, we have seen Chinese arms sales restraint in some areas where we have vital interests. For example, to the best of our knowledge, apart from the 1987/88 sale of missiles to Saudi Arabia, China has not delivered medium-range missiles to the Middle East. It is clear that in other specific cases China has taken international concerns into account and declined proposed missile exports to prospective buyers.

Underscoring Our Concerns

It is because serious concerns remain that we want to maintain a constructive nonproliferation dialogue with Beijing. We do not intend to ignore current problems, but isolating China by dismantling the framework for our relations is not the way to advance our nonproliferation objectives.

We have the means available to underscore our concerns where there are differences in our approaches to nonproliferation and we have used these legislative and executive branch tools. For example, we have imposed trade sanctions mandated by the National Defense Authorization Act on Chinese entities involved in missile-related activities. We have also announced the Administration's decision that, pending progress toward our nonproliferation objectives, we will not license high speed computers and will not issue further waivers of legislative restrictions on satellite exports. These new sanctions have been imposed in addition to the existing sanctions announced immediately following the June 1989 assault on Tiananmen and amplified by Congress in the Department of State Authorization

Act for FY 1990-1991. Moreover, we have not certified China under the bilateral agreement for nuclear cooperation that took effect in 1985.

Our policy mix of sanctions and cooperation at any given time is necessarily dependent on Chinese behavior. We are encouraged by China's indication in June that it is reviewing its policies with respect to Missile Technology Control Regime (MTCR) and the NPT. We seek China's adherence to the NPT and the MTCR guidelines and will encourage the Chinese to take concrete steps toward adherence to the key multilateral standards for international behavior established by these institutions. The Administration will continue to use the legislative authority that already exists and will take resolute action if the Chinese do not address favorably our nonproliferation concerns.

PART III: TRADE AND ECONOMIC ISSUES

The Administration is committed to achieving with China the same goals that have guided our trade policy with all other countries. We seek open markets and the opportunity for U.S. firms and their products to compete on fair and equal terms. To achieve these goals, and realize the principles of equality, mutual benefit and non-discrimination set forth in the U.S.-China Bilateral Trade Agreement, this Administration has pursued a policy of negotiation and engagement on trade issues with China. In particular, the Administration has sought to improve U.S. access to China's marketplace; to bolster Chinese protection of intellectual property; to end fraudulent practices by Chinese textile exporters using false country of origin declarations; and, to induce Beijing to undertake the economic and trade reforms required for membership in the GATT.

Reciprocal MFN tariff treatment underpins our ability to work constructively with the PRC. China's desire to retain access to the U.S. market has enabled us to engage Chinese leaders even during periods of tension. We believe that discontinuing MFN, or attaching conditions to its renewal, would cause serious harm to our trade interests and erode our ability to influence China's behavior on key trade issues.

The Past Decade of Bilateral Trade Relations

After decades of adhering to an import-substitution strategy that focused on minimizing China's reliance on outside sources of machinery and equipment, China began in the 1980's to seek outside sources of these goods. It also has increasingly drawn on foreign technology, expertise, and funds by actively encouraging joint ventures.

China's opening to the outside world has helped transform its economy, bolstering reform-oriented sectors that are not directly controlled by the central government. For example, the state sector now produces just over half of China's industrial output; in 1978, its share was 78 percent. China's dynamic rural industries, which are privately and collectively owned, have burgeoned. There are 30,000 foreign-invested ventures now in China, with a total contracted value of \$40 billion. The impact of China's open door has been particularly pronounced in the southern and coastal provinces, where 90 percent of the foreign investment and more than three-fourths of China's trade activities are located. This region, in turn, has become the primary engine of economic reform in China largely as a result of the introduction of market concepts to Chinese employees of joint ventures and to citizens engaging in commercial exchanges with the West. The economic autonomy fostered by this interaction contributes to increased political and even individual self-determination.

The United States has been a vital partner in this transformation. Following Congressional approval of the bilateral trade agreement, the United States and China established formal trade relations and reciprocally granted most-favored-nation (MFN) status in 1980. Growth in our commercial ties has helped to change China and to bring it into the global trading system. Since the resumption of normal trade relations, U.S.-China two-way trade has increased almost 770 percent, from \$2.3 billion in 1979 to over \$20 billion last year.

- We are now China's second-largest trading partner and its largest export market.
- China is our tenth-largest trade partner, up from fifteenth in 1981.
- Over 1,000 U.S. firms have invested more than \$4 billion in China and another \$5 billion in Hong Kong related primarily to trade with the PRC.
- In 1990, the United States exported \$4.8 billion worth of goods to China, including:
 - \$749 million worth of aircraft
 - \$544 million worth of fertilizer
 - \$512 million worth of grain
 - \$281 million worth of cotton yarn and fabric
 - \$273 million worth of chemicals
 - \$264 million worth of electric machinery
 - \$238 million worth of wood and wood pulp
 - \$227 million worth of scientific instruments.

Commercial relations with the United States have exerted positive influences on China's business and economic practices since 1980. China has shifted away from total reliance on a strongly centralized economy, shown greater tolerance for experimentation with market mechanisms to regulate its domestic economy, and decentralized and liberalized its foreign trade practices.

Regression in China's Trade Policies

China's opening to the outside world has not been smooth. Over the past decade, attempts to accelerate the implementation of market-oriented reforms have been followed by Beijing's recentralization of control, as concern about the country's ballooning trade deficit led Beijing to step in to regain some of the trade authority it had relinquished.

Moreover, throughout the period since the normalization of trade relations and the granting of reciprocal most-favored-nation trading status in 1980, China's web of barriers to imports has made it difficult for many U.S. exporters to gain access to the Chinese market. U.S. firms have also had difficulty securing protection for their intellectual property.

U.S. trade negotiators have long been engaged with the Chinese Government, both in bilateral negotiations and in multilateral consultations at the GATT held to review China's application for membership. We have sought to ensure that bilateral commercial relations develop in accord with the principles that underlie our bilateral trade agreement: equality; mutual benefit; and nondiscrimination. From 1979 through 1987, Chinese authorities made some progress in reducing nontariff barriers to imports, in improving transparency, and in protecting the intellectual property of foreigners.

This trend has been reversed over the last three years.

- Since 1988, Chinese trade policies and practices have become more protectionist, nontariff barriers to imports have proliferated, and the trade system has become less transparent. These policies undoubtedly contributed to a 17 percent decline in U.S. sales to China in 1990. China was the only major foreign market for U.S. goods and services in which our exports declined in 1990.
- Despite intensive bilateral negotiations with Chinese authorities since the USTR in 1989 placed China on the "priority watch list" of countries providing inadequate intellectual property protection--including three rounds of meetings over the past five months--China has failed to live up to the commitments contained in the bilateral Memorandum of Understanding (MOU) signed in May 1989.

At the same time, other problems have developed in our bilateral trade relationship. For example, to bypass U.S. textile and apparel quotas, Chinese exporters have increasingly resorted to shipping these products to the United States via third countries using false invoices and counterfeit visas. Also of concern to us has been the apparent lapse in China's commitment to economic and trade reforms that would bring the country in line with the GATT's free-trade principles. China's reassertion of central control over the past few years has called into question its willingness and ability to undertake the obligations that would be required of China as a contracting party to the GATT.

Steps the U.S. Government Has Taken and Will Take to Address Bilateral Trade Problems

In six key areas of our bilateral trade and economic relations, the Administration has taken steps to resolve trade problems. We are prepared to do more.

On Market Access

- Beginning in the fall of 1990, the Administration resumed sub-cabinet level meetings with the Chinese, that had been suspended since June 1989, to secure Chinese actions to reverse the growing list of new protectionist measures.

- In April 1991, the Administration formally set in motion a market access initiative that continued with the visit to Beijing, in mid-June, of an interagency delegation to discuss market access issues. In meetings with senior Chinese officials, U.S. Government officials raised nine types of market access barriers, including: the lack of transparency in rules and regulations; the expansion of import licensing requirements; the use of import substitution policies; the proliferation of import bans and quotas; the growth of standards, testing, and certification requirements, including discriminatory "quality standards" procedures for imports; the high level of many import tariffs; the unnecessary use of certain phytosanitary regulations; the uncertainties regarding government procurement and tendering regulations; and the lack of information regarding China's major development projects.

- The Administration has proposed holding another round of market access consultations in August 1991. If that round of negotiations fails to yield substantial commitments from the Chinese authorities to dismantle market access barriers, the Administration will self-initiate Section 301 action to address those barriers the removal of which offers the most potential for achieving U.S. trade policy objectives and increasing U.S. exports.

On Intellectual Property Protection

- On April 26, 1991, USTR identified the PRC as a priority foreign country that denies adequate and effective protection of intellectual property rights. Accordingly, on May 26, 1991 USTR initiated a Special Section 301 investigation on the basis of four problem areas: (1) inadequate copyright protection, (2) inadequate patent protection, (3) inadequate trade secret protection and (4) ineffective enforcement of trademarks. Consultations with the Chinese are ongoing. The first round of consultations under the Section 301 investigation occurred in mid-June and a second has been proposed for August.

- The deadline for making a determination under Section 301 is November 26, 1991. This may be extended for three months if China is making substantial progress in drafting or implementing measures that will provide adequate and effective protection of U.S. intellectual property rights. At that time, the USTR must determine whether the acts, policies and practices of the PRC are actionable under Section 301 and what retaliatory action, if any, is appropriate.

- If the consultations fail to produce adequate and effective protection of intellectual property rights, the Administration will take retaliatory action.

On Textile Transshipments

- The U.S. Customs Service has been vigilant in documenting cases of Chinese textile transshipments over the past year.
- In August 1990, USTR held consultations with Chinese authorities on the transshipment issue. Additional consultations took place in November 1990, March 1991, and May 1991.
- The U.S. Government "charged" China's quotas for goods that were sent to the United States under false country of origin declarations valued at over \$85 million.
- China has begun to take actions to curtail textile fraud since the December charges were made. For example, it issued regulations prohibiting reexports through a third country to countries that have signed textile agreements with China. Further, the Chinese Government has issued provisions for the punishment of those who violate the regulations.
- The Administration has prepared more charges valued at about \$14 million that we anticipate will be levied after consultations with China next month.
- The Administration will increase the number of U.S. Customs officials dedicated to investigating circumvention.
- If transshipment persists, we will be prepared to take additional action against China.

On Forced Labor

- The importation of goods produced with forced, convict or indentured labor is prohibited by 19 USC Section 1307, which also directs the Secretary of the Treasury to prescribe regulations for enforcement of the provision. The Secretary of the Treasury, under 19 CFR Section 12.42, has delegated to the Commissioner of Customs, authority to determine that a class of goods is the product of forced labor and exclude those goods.
- Customs has been investigating imports alleged to be the product of forced labor in China. Customs has interviewed emigres about forced labor practices in China. Customs is also analyzing import samples to determine if they match the descriptions provided by the emigres and others. Additional special agents have

been detailed to Hong Kong to assist in the investigation.

- Although the letter from Senator Baucus and fourteen co-signers did not specifically address the issue of prison labor imports, appropriate action is called for to fulfill the intent of existing law. The Administration therefore proposes to negotiate a memorandum of understanding with China on procedures for the prompt investigation of allegations that specific products exports to the U.S. are being produced by prison labor.
- Pending negotiation of the MOU, Customs will temporarily embargo specific products from China when there is reasonable indication that they are made by prison labor. Embargoes will be lifted only after the Chinese Government or the Chinese exporter provides credible evidence that the products are not produced by prison labor.

Multilateral Lending to China

- The G-7 consensus, led by the United States, was successful in prohibiting all MDB lending to China from June 1989 to February 1990 in response to the international outcry against the crackdown by the Chinese authorities at Tiananmen Square.
- From February 1990 to July 1990, the G-7 consensus supported a gradual resumption of World Bank lending to China for projects that clearly met basic human needs (BHN). The consensus held firm and actively prohibited other loans from Board consideration. Only five loans (totalling \$590 million) were approved in WBFY 1990. This is substantially less than pre-Tiananmen Square levels of World Bank commitments to China, which were \$1.4 billion in WBFY 1988 and \$1.3 billion in WBFY 1989.
- At the Houston Summit in July 1990, several G-7 countries decided that China's long-term development needs argued for lending outside the BHN limits favored by the United States. Accordingly, the G-7 Houston Summit Declaration of July 1990 on MDB lending to China expanded the boundaries of permitted MDB lending to China to include loans which were environmentally beneficial or which supported market-oriented economic reform. Only BHN loans were considered by the World Bank Board until December 4, 1990 when the market oriented economic reform loan for Rural Industrial Technology was approved by the Board. On November 29, 1990, the ADB approved its first loan to China since Tiananmen Square, Agricultural Bank Project, which the U.S. did not support. Despite the approval of infrastructure project loans by the World Bank and the

Asian Development Bank, the U.S. has and will continue to withhold support on all loans that do not meet BHN criteria.

On GATT Accession

- Since China applied for GATT membership in July 1986, the United States has been a leading participant in the collective efforts of major GATT Contracting Parties to develop terms for China's GATT participation that will support the objectives of the GATT and will influence Chinese Government policies to become, over time, more compatible with the GATT framework for world trade.
- U.S. and other major GATT contracting parties' concerns about China's ability and willingness to live up to GATT obligations, particularly since June 1989, have stalled progress in the Working Party established to consider China's application for membership in the GATT.
- The Administration intends to continue to press Beijing to undertake trade and economic reforms so that its GATT application can advance and its trade practices be brought under GATT disciplines.
- At the same time, the Administration will begin to work actively with other GATT members to resolve in a favorable manner the issues relating to Taiwan's GATT accession. U.S. support for Taiwan's accession as a customs territory would be consistent both with GATT legal criteria and the "one-China" policy which acknowledges the Chinese position and has been adhered to by successive U.S. administrations.
- Taiwan's GATT accession would yield substantial trade and commercial benefits to the United States and to the international trading system.
 - Taiwan has indicated that it is prepared to accede to the GATT as a developed economy, to bind virtually all its tariffs, and to join the major non-tariff measure GATT codes.

The Importance of MFN

As highlighted above, the Administration is aggressively seeking to resolve outstanding bilateral trade issues with the PRC. MFN underpins our ability to work constructively with the PRC. We believe that discontinuing MFN, or attaching conditions to its renewal, would cause serious harm to our trade interests, and would render futile pursuit of the initiatives outlined above.

It would reduce our leverage in market-access, intellectual property rights protection, and other trade-related negotiations. China's desire to retain access to the U.S. market has enabled us

to engage Chinese leaders in consultations on bilateral and multilateral issues even during periods of tension. Because China is not a GATT member and not bound by GATT trade disciplines, it is especially important to have many levers that enable us to engage the Chinese on trade issues.

It would hurt U.S. exporters. If the United States rescinds China's MFN trading status, China will not only discontinue MFN tariff treatment for the United States, but would likely cease purchasing billions of dollars of U.S. wheat, aircraft, fertilizer, cotton yarn and fabric, wood and wood pulp, electric machinery, scientific equipment, and chemicals. Foreign competitors, whose goods would be subject to lower tariffs, would be quick to exploit our departure. Lost shares of China's market would not easily be regained even if MFN were restored at some future date.

It would hurt U.S. consumers. Tariffs on the 25 most important U.S. imports from China would rise from the present average tariff rate of 8.8 percent to an average rate of 50.5 percent. These increases would mean sharply higher prices for lower-end Chinese goods. The costs to U.S. consumers would be largely borne by poorer Americans, who are primary consumers of low-cost Chinese products.

It would damage America's reputation as a reliable trade partner. Our trade competitors will not join us in denying MFN status to China. Other Chinese trade partners, especially in Asia, urge that China's MFN status be retained.

It would hurt investors, businesses, and workers in Hong Kong. Loss of MFN would impede China's integration into the regional economy, a development crucial to regional stability particularly as we near the 1997 deadline for Hong Kong's reversion to Chinese sovereignty. It could cost over 43,000 jobs in Hong Kong and result in direct revenue losses of approximately \$1.2 billion dollars. Hong Kong's GDP growth could be curtailed by as much as two percent.

It would set back efforts to bring about meaningful economic reform in China. A disproportionate burden of the MFN denial would fall on the primary engine of economic reform in China--the economies of the southern and coastal provinces. In Guangdong province, for example, 40 percent of industrial output is produced for export, half of which goes to the United States. Sectors that fall outside of the direct control of the central government have been especially important to China's development as an exporter; one-third of China's exports currently come from rural (individual and collectively owned) industries and from foreign-invested ventures. The foreign ties these provinces and non-state-owned factories developed with the outside world prior to Beijing's reassertion of central control in mid-1989 enabled these provinces to weather the austerity program; without these foreign markets, Beijing's grip would have been all the tighter. As Beijing's influence over the regions and sectors most closely integrated into the global economy has diminished, these regions

and sectors have become increasingly sensitive to global economic conditions. Revocation of China's MFN trading status would cause unemployment to rise and factory losses to mount in export-producing regions.

Conclusion

Those who engineered the violence in China in June 1989 are unlikely to bear the economic costs associated with the denial of MFN. Instead, those who suffer would be American businesses and their employees, American consumers, and the people of Hong Kong and the progressive areas of China.

China's opening to the outside world over the past decade has accelerated growth in the non-state sectors of the economy; resulted in strong links between China's coastal regions and the global economy that have enabled this reformist region to weather Beijing's periodic efforts to reimpose central government control over economic activity; and introduced market concepts to a generation of Chinese managers involved in joint ventures, trade negotiations, and training in the West. For this process to continue, China's most-favored-nation treatment in the United States is essential.

OFFICE OF CABINET AFFAIRS STAFFING MEMORANDUM

Date: 5-24-90

Due by: _____

Subject: Fact Sheet -- MFN for China

From: _____

| | ACTION | CONCUR | FYI | | ACTION | CONCUR | FYI |
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Comments:

FACT SHEET ON CONTINUATION OF MFN FOR CHINA

-- China Meets the Emigration Requirements of Jackson-Vanik. Approximately 17,000 Chinese nationals received U.S. immigration visas to travel from the mainland in 1989. Chinese immigration continues to meet U.S.-imposed limits. Other visa levels are about the same as the previous year's, with privately sponsored students up sharply and government sponsored students down.

-- U.S. Business Would Be Hurt. Investments of \$4 billion in China would be put at risk, as would U.S. exports to China which totaled nearly \$6 billion in 1989. The Chinese would retaliate for loss of MFN with higher duties, particularly on products where the U.S. has serious competition. Major exports at stake are:

- Wheat. \$1.1 billion (20% of US exports)
- Aircraft/Aerospace Equipment. (Current prospects of \$1 billion per year with big contracts pending)
- Fertilizer. \$487 million.
- Cotton. \$259 million.
- Timber/paper. \$262 million (10-20% of US log exports)
- Computers/machinery. \$342 million.
- Acids. \$162 million.

-- U.S. Consumers Would Be Hurt. China supplies about one-third of US toy consumption, 9% of footwear, 13% of imported apparel, and a rapidly increasing volume of electronic products. Non-MFN duties would raise landed costs an average of 40%.

-- Hong Kong Would Be Hurt. Already shaken by the events in China, MFN loss would damage the colony by costing as many as 20,000 jobs and as much as 2.5% of GNP growth.

-- Denial of MFN Will Harm Reformers and Strengthen Hardliners. In China, the advocates of political and economic reform and of greater human rights depend on outside contacts and support. Cutting them off will weaken them while giving hardliners a nationalistic scapegoat for their failing policies.

-- Sanctions Remain in Place. US pressure for reform is contained in the sanctions already enacted. The Administration will continue to press for progress on our human rights and other concerns. MFN status is not a concession; it is the basis of everyday trade. Our competitors will not follow us in denying MFN.

-- Engagement Pays Off in the Long Run. Western involvement in China has helped produce the major social and economic changes behind the Tiananmen demonstrations. Despite the past year's repression, greater interaction will lead ultimately to greater influence.

MOST-FAVORED-NATION (MFN) TRADE STATUS FOR CHINA

- o The Administration and Congress both share the same goals in China--make clear our deeply held views on human rights and encourage conciliatory policies and a reinvigoration of political and economic reform.
- o The President, after careful consideration, decided to extend China's most-favored-nation (MFN) trade status for another year. In reaching this determination, the President weighed not only the requirements of the Jackson-Vanik amendment, which obligate him to consider whether MFN renewal would substantially promote freedom of emigration, but also the broader question of whether MFN would advance the cause of human rights and reform in China. On balance, the President concluded that extending MFN would promote US objectives in both these areas and protect other vital US interests as well.
- o Emigration. Approximately 17,000 Chinese emigrate from the mainland to the United States every year. This emigration flow has continued since the military crackdown in June 1989. While the Chinese Government has imposed some new travel restrictions on students, it has continued to permit emigration travel since Tiananmen. US numerical limitations, and not Chinese restrictions, limit the number of Chinese who emigrate to the United States.
 - In our judgment, continuation of MFN status will help to preserve the gains already achieved on freedom of emigration and encourage further progress in the future. Thousands of Chinese families have been reunited in the United States through emigration. The contacts which these immigrants maintain with friends and relatives in China help to encourage positive change there and promote friendly relations with the US. Denying China MFN status removes an important incentive for permitting emigration and invites retaliation in the form of new travel restrictions.
- o Broad Human Rights. The President believes that a continuation of MFN for China is vital to advancing the cause of human rights and in supporting those Chinese who seek a modern, progressive China.
- o Granting China MFN status, which is the tariff treatment the US accords all but a small number of its trading partners, was one of the key elements in a package

normalizing diplomatic relations in 1979-80. It signaled that the US would treat China as an equal with other countries and facilitated a major expansion in our economic relations. But MFN's impact extended far beyond commerce and trade.

- o The prospect of rapid modernization through increased trade and investment with the US encouraged a broader opening to the West, gave further impetus to market-oriented economic reforms, created expanded opportunities for people-to-people contacts, and justified the sending of thousands of China's best and brightest students to the US for higher education where they were exposed to Western values and democratic ideals.
- o Denying MFN status would adversely affect our ability to maintain those contacts and thereby to help sustain the impetus for internal reform.
 - China would view MFN denial as a hostile act, and a further deterioration in the relationship would result.
 - In this strained atmosphere, Chinese contacts with Americans across the board--business, academic and scientific--would be more difficult and may be severely curtailed. Those Chinese with an interest in furthering China's opening to the West and seeking positive change would be most affected.
 - MFN denial would likely bolster the position of conservatives in the leadership who want to restrict Western influence, give internal policies a more ideological orientation and maintain strict government controls on society and the economy. On the other hand, reformers, who could up until now point to substantial benefits from good relations with the US and a deepening of market-oriented policies, would be put on the defensive.
- o MFN denial would remove an important incentive for China to take into account a broad range of US interests--on human rights, missile and arms sales, fair trade practices abroad, and cooperation on regional issues, such as Cambodia and Korea.
- o Allied Solidarity. The US and its G-7 allies (France, Germany, UK, Japan, Canada and Italy) have thus far maintained a united position on China policy. Since the Paris Summit in July 1989, there has been a G-7 consensus against a general resumption of World Bank lending to China. Other G-7 countries have also suspended arms exports to China and are limiting high-level contacts.

-- While our allies all agree China should do more to improve the human rights situation, they also believe that MFN is important and plan to continue this trade status for China. The US would be the only Western country to withdraw MFN if the President did not renew the waiver. We believe a united G-7 position puts more pressure on China than unilateral US actions.

- o Economic Implications. The economic consequences of removing China's MFN status would also be severe--for US business, US consumers, Hong Kong and workers in export industries in China.
- o Since receiving MFN status in 1980, US-China trade has nearly quadrupled, reaching \$18 billion in 1989. US exports totalled \$6 billion, and China remains a potentially large market for a broad range of US products. Major US exports are: wheat, commercial aircraft, phosphate fertilizer and high-tech equipment, such as computers and scientific instrumentation. (See attached fact sheet for details.)
- o The US has become China's largest market, absorbing 25 percent of China's total exports. China's top 20 exports to the US by value would face average duty rates of nearly 60 percent if MFN status is revoked--in some cases ten-times higher than with MFN privileges.
- o Retaliation is a certainty. China would apply its higher non-MFN duty rates to imports from the US and could use a variety of administrative measures to restrict market access by US companies (e.g., through foreign exchange allocations, import licenses, quality standards and restrictions on imports competing with local production).
- o US firms that have worked hard over the last ten years to develop business ties and market share within China would lose that business--perhaps permanently--to other suppliers in Europe and Japan. No other Western country is planning to deny China MFN status. Retaliation therefore would be on focused US firms.
- o Effect on Consumers. US consumers would also suffer. MFN denial would lead to sharply higher prices on imports from China. Chinese manufacturers currently supply one-third of American toy consumption, 10 percent of footwear consumption, close to 15 percent of imported apparel consumption and a rapidly increasing volume of consumer electronic products. According to the US-China Business Council, non-MFN tariffs would increase the landed cost of Chinese products by 40 percent. Given the mix of Chinese exports to the US, the impact of increased prices is likely to fall disproportionately on low-income consumers.

- o Hong Kong Impact. Revoking MFN -status would also have long-term negative effects on Hong Kong, threatening the island's stability and prosperity in the run-up to 1997 when Beijing reassumes control.
 - Hong Kong entrepreneurs have invested in thousands of Chinese enterprises, particularly in Guangdong's Pearl River delta region in South China, to take advantage of low-cost manufacturing. Hong Kong-invested enterprises in South China employ some 2 million Chinese. An additional 10,000-15,000 South China enterprises do processing and assembly work for Hong Kong companies.
 - Of a total of \$25 billion in Chinese exports to Hong Kong in 1989, \$24 billion were re-exported to other countries. The United States is by far the largest market for Chinese reexports through Hong Kong, taking more than \$8.5 billion in 1989.
 - The dropoff in Chinese exports to the US would have a direct impact on Hong Kong firms involved in transshipment of goods to the US, including banking, insurance, shipping, and legal services.
 - MFN withdrawal would be a serious blow to confidence in Hong Kong. Net emigration from Hong Kong is now running about 40,000-50,000 annually, resulting in a serious shortage of skilled labor and mid-level managers. A sharp deterioration in US-China trade relations would heighten concerns about Hong Kong's future at a time when confidence is already weak because of Beijing's heavy-handed suppression of dissent on the mainland.
- o In short, the President has decided to extend China's MFN status because it serves clear US interests in several important areas--emigration and human rights, the need for reform in China, US business, US consumers and Hong Kong's stability and confidence.
- o Need for Further Human Rights Improvements. In notifying Congress of his determination to renew MFN for China, the President emphasized that he remains seriously concerned about human rights violations in China and is personally disappointed that the Chinese Government has not taken more decisive steps to demonstrate a commitment to internationally accepted human rights, despite repeated expressions of concern by the US and many other Western countries. The President has also indicated that the US Government intends to press vigorously during the coming year for significant improvement in China's human rights practices.

- o Sanctions to Continue. The extension does not signal a return to business as usual with China. The President has reaffirmed that he will maintain the sanctions against China he authorized in June 1989 on arms exports, high-level government exchanges and postponement of multilateral development loans.

- o We should not let our frustration with Beijing's slow response to our concerns lead us to take unilateral actions which, in the end, only serve to undercut our long-term objectives. Denying MFN would do just this. It would also result in the United States losing the leverage it has gained over the last decade to influence positively the course of human rights developments in China.