Appendix

Other East-West Trade Issues

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This report is not intended to be a comprehensive analysis of U.S. trade relations with the Communist world. Rather, it focuses on U.S. trade policy toward the U. S. S. R., as governed by the Export Administration Act (EAA). Of the important issues which lie outside the narrow scope of this study, two seem to merit particular attention: U.S. trade relations with the People's Republic of China (PRC) and the role of credit in East-West trade. These are the subject of this appendix, which seeks to document significant developments in these areas over the past 4 years.

THE PEOPLE'S REPUBLIC OF CHINA

In 1972, the U.S. Government, which had previously banned virtually all trade with China, embarked on a policy of "evenhandedness" in economic relations with China, i.e., treating it and the Soviet Union in the same fashion. This policy began to erode in 1978, when President Carter imposed foreign policy controls on certain oil and gas equipment exports to the Soviet Union, but not to China or to other Communist countries.[1] The Soviet invasion of Afghanistan accelerated the process of differentiation. The vehemence of the Chinese reaction against the U.S.S.R. assuaged, even if it did not entirely remove, lingering doubts about China's commitment to opposing the Soviet Union and seeking closer relations with the United States. Deepening Sine-American political relationships led to a liberalization of U.S. export controls, the first concrete indication of which was Defense Secretary Harold Brown's announcement that the United States was willing to consider licensing exports of some dual-use military equipment to China on a case-by-case basis. Examples of possible exports were trucks, communications equipment, and early warning radars. Furthermore, in January 1980, Congress approved a trade agreement with China, and the U.S. Government decided to license Chinese purchases of nonlethal military support equipment on the Munitions Control List. Since 1978, U.S.-PRC trade has grown more than fourfold in nominal terms. (See table 9.)

The new U.S.-PRC trade policy has been reflected in the reclassification of China in U.S. export control regulations so that it is no longer treated in the same fashion as the U.S.S.R.[2] The change was justified on the basis of the differing grounds on which the identification of exports detrimental to U.S. security is carried out in the cases of China and the Warsaw Pact countries. These differences were reflected in the approval of licenses for secure communications equipment for Chinese diplomatic facilities in the United States, computers for use in metal refineries, peripheral enhancements for computers previously exported to China by U.S. firms, technology for manufacturing transport helicopters, and some integrated circuits. In September 1980 the Carter administration announced new licensing guidelines. They included the following:

- Licenses would no longer be automatically denied when the end-user was engaged in military activities.
- Licenses for equipment or data for manufacturing military items would probably be denied if the military items themselves would not be approved for export.
- Licenses would not be approved if the potential military application was "so significant that the export would present an unacceptable risk regardless of the stated end-use."[3]

The Reagan administration's review of export licensing policy included reconsideration of exports to the PRC. One of the first indications of the new policy was the announcement in June 1981 of President Reagan's decision to liberalize export

[1] U.S. Congress, House Committee on Foreign Affairs, Subcommittee on Europe and the Middle East, *An Assessment of the Afghanistan Sanctions: Implications for Trade and Diplomacy in the 1980* (Washington, 1). C.: [J. S. Government Printing Office, 1981), pp. 115-116,

[2] *45* FR 27922.

[3] "New Guidelines Set for Exports to China," *Business America,* Oct. *6, 1980, p. 20.*

Table 9.—U.S.-PRC Trade, 1978-82
(million U.S. dollars)

	U.S. Exports	U.S. Imports	Trade Turnover
1978	*$818.24*	*$323.95*	*$1,142.19*
1979	1,716.50	592.28	2,308.78
1980	3,748.99	1,058.34	4,807.33
1981 ...., . .	3,598.60	1,895.33	5,493.93
1982	2,904.54	2,283.70	5,188.24

SOURCE U S Department of Commerce

controls, to make China eligible to purchase military equipment, and to ask Congress to remove restrictive clauses from the legislation that provide for equal treatment of the PRC and the Soviet Union. In July 1981, the Department of Commerce (DOC) announced more specific guidelines, stating a "predisposition" to approve exports at twice the technical level previously exportable to China.[4] Applications for exports at higher levels would be considered on a case-by-case basis. In addition, DOC announced that the Department of Defense (DOD) would only review applications for exports subject to CoCom controls. Unilateral review by Commerce was expected to significantly speed the licensing process.

The new guidelines were confirmed and expanded on December 29, 1981.[5] According to the Federal *Register* notice, the Reagan administration determined that:

> . . . it is in our national interest to foster a strong, secure and friendly China, capable of deterring potential aggressors and contributing to peace and stability, and to participate in China's economic development for the benefit of China and for the United States. The Administration recognizes the need for a clear trade policy that will lend flexibility and predictability to American business in trading with China, while ensuring our national security, promoting U.S. foreign policy and protecting U.S. commercial interests.

This statement of policy notwithstanding, applications are to be reviewed to ensure that exports to the PRC are consistent with the policy expressed in EAA of restricting the "export of goods and technology which would make a significant contribution to the military potential of any country or combination of countries which would prove detrimental to the national security of the United States. " The regulations reaffirmed the 1980 guidelines and explicitly doubled the technical level for permissible exports to the PRC.

U.S.-PRC trade policy under the Reagan administration has not always appeared consistent. In June 1982, Ambassador Stoessel speaking on behalf of Secretary Haig to the National Council on U.S.-China Trade, characterized China as "a friendly country with which we are not allied, but with which we share many common interests."[6] Nonetheless, at about the same time the administration reportedly tightened licensing policy towards the PRC in response to intelligence reports of technology leakage to it and the Soviet Union.[7] Yet, in September 1982, the Reagan administration licensed the sale of a sophisticated computer, used in the United States for simulating missile flights, to the PRC.

U.S. exporters and others have also charged that U.S. licensing policy towards China remains unclear. In their view, licensing decisions have been speeded somewhat, but still remain slow, and licensing has not been liberalized as much as the new policy would suggest, preventing U.S. exporters from competing effectively. They suggest several reasons: First, despite the announced change in policy, DOD is still reviewing about the same number of applications. Second, licensing agencies interpret the new guidelines differently. Commerce has a "presumption of approval" in cases falling within the "2-times guideline, " but Defense only a "predisposition" to approve. Third, DOD still takes a tough position on PRC trade.[8] In addition, they argue that unilateral U.S. controls on software place them at a disadvantage vis-à-vis other Western firms and that there are no clear guidelines for software exports.

In the opinion of many U.S. exporters, the fundamental problem is the ambiguity of U.S. policy. This view was forcefully expressed by an official of the U.S.-China Trade Council in testimony before Congress. Commenting on the December 29 Regulations, he argued that:

> The new regulations thus give with one hand and take away with the other. This leaves the business community and the bureaucracy to work with a system that seeks to "foster a strong, secure, and friendly China capable of deterring potential aggressors," but prohibits contributions to China's military potential. Making this policy even more difficult to implement is that, because China is classified as a country to which exports are controlled for national security reasons, the Secretary of Defense is required . . . to recommend disapproval of any export of goods or technologies that would make a significant contribution to China's military potential. With the question of whether China is a friend or an adversary unresolved, it is not surprising that there are interagency disputes over implementation. Nor is it surprising that technical guidelines set out under administration policy have not been followed.[9]

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[4] U.S. International Trade Commission, 29th *Quarterly Report to Congress and the Trade Policy Committee on Trade between the United States and the Nonmarket Economy Countries During 1981* (Washington, D. C.: March 1982), pp. 33-34.

[5] 46 FR 62836.

[6] Reprinted in *Department of State Bulletin*, vol. 82, No. 2064, July 1982, p. 50.

[7] Michael Weisskopf, "Chinese Trade Issues Seen Snagging Shultz, " *Washington Post*, Jan. 31, 1983, p. A12.

[8] Chris Brown, "The problems With Country Group P," *China Business Review*, vol. 9, No. 2, March-April 1982, pp. 21-22.

[9] Prepared Statement of Roger W. Sullivan, Executive Vice President of the National Council for U.S.-China Trade, before the Subcommittee on International Economic Policy and Trade, Committee on Foreign Relations, U.S. House of Representatives, Mar. 8, 1983, mimeo., p. 2. (Emphasis in the original.)

Others in the United States have the opposite concern; i.e., that export controls for the PRC have been liberalized too far.

Chinese officials have been reported to be displeased at U.S. licensing policy, particularly at delays in licensing. Referring to this issue, Huang Hua, the former Foreign Minister, told the Council on Foreign Relations, "In view of the recent developments . . . one cannot help asking, 'Does the United States view China as a friend or a foe?'"[10]

An important test of U.S. licensing policy towards China will be license action for a satellite ground station to receive and process data from the LANDSAT-D satellite, which provides agricultural and geophysical data. The computers and other equipment for the ground station are not considered to have direct military applications, but in the view of many U.S. experts, could conceivably be put to military use. The issue first arose during the Carter administration. On January 31, 1980, it signed an agreement that would allow the purchase of a ground station, but the PRC delayed the transaction, probably because of a shortage of hard currency. On October 8, 1982, the Reagan administration announced that it was prepared to consider applications to export satellite ground stations and notified potential sellers that technical and procedural guidelines were available.[11] On January 17, 1983, China announced that it had signed a contract with a U.S. firm, Systems & Applied Sciences Corp., to purchase the necessary equipment. Although the administration has approved the sale in principle, the firm will have to apply for a license.

Technology sales cannot be viewed in isolation from other aspects of U.S.-PRC relations, which have recently deteriorated. On the U.S. side, there are serious concerns about the PRC basic orientation in international politics and about reports that it has supplied nuclear aid to South Africa and Pakistan. On the Chinese side, there are concerns about U.S. policy towards Taiwan, textile exports to the United States, and policy on sales of nuclear equipment.

Thus, U.S. licensing policy towards the PRC has been significantly liberalized under both the Carter and Reagan administrations. This policy, which was effectuated through administrative measures, illustrates the large degree of leeway conferred on the President by EAA. Since this policy could be reversed, those favoring greater liberalization in practice and in policy advocate statutory changes.

[10] Quoted in Weisskopf.
[11] 47 FR 44595.

CREDIT ISSUES

The Polish debt crisis, Romania's repayment problems, and efforts by both the Carter and Reagan administrations to curb or raise the cost of Western credit to the Soviet Union all reinforce the importance of the role of credit in East-West trade. U.S. concerns about future Eastern bloc creditworthiness now extend beyond Poland and Romania to countries such as the Soviet Union and the German Democratic Republic, once thought to be excellent credit risks. Part of this concern centers on the danger of "reverse leverage, " in which the borrower acquires influence over the lender through the very size of its debt.

It is possible that slower growth and declining creditworthiness will moot the issue of private and official credit to the East, as bankers and governments focus on collecting old loans rather than extending new ones. Many believe that the Eastern countries' shortage of hard currency makes credit the most important of all Western commodities to control. Closely related to this point of view is one that holds that if trade is to be used as an instrument of foreign policy, controls should be placed not simply on exports, but also on credits and imports as well. However, the United States alone has little leverage in this area: the Jackson-Vanik amendment precludes the extension of official credits to most nonmarket economy countries, and except in time of war or national emergency there is no legal mechanism for restricting private credits, although the Government may informally request U.S. banks to use restraint in their lending policies.

Official Credits to the Soviet Union

Under the Carter administration, the United States launched a dual effort to curb or raise the cost of credit to the Soviet Union. One part entailed negotiations within the Organization for Economic Cooperation and Development (OECD) to persuade members to raise interest rates from the levels set in 1978 in the Arrangement on Officially-Supported Export Credits. Adhered to by 22 countries, the Arrangement specifies minimum rates for official credits to all nations. Countries are assigned to one of three categories (relatively rich, intermediate, and relatively poor) on the basis of per capita national income.[12] A second

[12] Besides the United States, the participants in the Arrangement are the European Economic Community, Australia, Austria, Canada, Finland, Japan, New Zealand, Norway, Portugal, Spain, Sweden, and Switzerland.

effort focused directly on credits to the Soviet Union.

Reducing subsidized credit to the Soviet Union poses technical and political difficulties for the United States. The former involve the problem of defining and measuring subsidies. There are at least two ways of defining a subsidy.[13] The first is Government actions to reduce the cost of funds to the borrower, including direct payment of a percentage of the interest rate on credits offered by commercial banks, official credits at less than market rates, and reimbursement of officially backed credits in the case of a default. In the past, guarantees on loans to the Soviet Union would not necessarily have lowered the effective rate of interest since the U.S.S.R. has been a good credit risk. A second definition of subsidy is the net transfer of resources from tax receipts from the lender country to the borrower.

The difficulties raised by these various definitions are illustrated by the disagreement on whether the West German Government subsidizes credit to the Soviet Union. West Germany does not extend direct credits, but guarantees export financing through the Hermes insurance program. Many in the United States consider Hermes guarantees to be subsidies, but the Germans argue the contrary.[14]

A more serious source of difficulties on the subsidy issue is the divergence of Western views. The Reagan administration prefers to allow market forces to set credit rates. But most other countries' normal credit policies toward all sovereign borrowers, including the Soviet Union, could be termed "preferential.[15]

Following the invasion of Afghanistan, the Carter administration requested that its allies halve official credits and guarantees to the Soviet Union and end their credit subsidies. This effort yielded modest results: The Common Market agreed in February 1980 not to offer long-term credits to the Soviet Union at rates lower than the 7.75 percent specified in the Arrangement. The Italian Government delayed negotiating a credit agreement with the U. S. S. R.; the British Government decided not to renew a line of credit (but many observers noted that the Soviet Union had not used all of it); and the Japanese Government delayed issuing new credits for joint projects with the Soviet Union for several months.[16]

In addition, the Carter administration urged increases in OECD Arrangement rates. The participants agreed on slight increases, effective July 1, 1980, and on further negotiations in the fall. But the fall negotiations failed, despite agreement in the North Atlantic Treaty Organization (NATO) ministerial meeting and at the Venice Summit that an acceptable means of bringing the rates "closer" to market terms should be reached by December 1, 1980. At French insistence, the Common Market offered only a small increase, which the U.S. termed "grossly inadequate. " Japan-justifiably in the U.S. view—declined to accept the agreement, which would have forced it to charge above market rates.[17]

The Reagan administration believes that Western governments should not offer any subsidies on credits to the Soviet Union, which after all, is responsible for rising Western defense expenditures. In the administration's view, the slowdown of Soviet economic growth and hard currency earnings in the 1980's will have the effect of making the U.S.S.R. less creditworthy and more eager to borrow from the West, especially at rates subsidized by Western governments. The administration is also concerned about the possibility of reverse leverage.[18]

The Reagan administration pressed for increases in the OECD rates on the grounds that the Arrangement allowed for an estimated $5.5 billion in subsidies in 1980.[19] At the initiative of the United States, the participants agreed to raise the minimum interest rate from 7.5 to 10 percent, effective November 16, 1981.

During the spring of 1982, the administration also attempted to persuade the allies to reduce or raise the cost of official credit to the Soviet Union. Several U.S. delegations visited West European capitals reportedly with the following agenda:

[13]U.S. Library of Congress, Congressional Research Service, The *Premises of East-West Commercial Relations: A Workshop Sponsored by the Committee on Foreign Relations, United States Senate* (Washington, D. C.: U.S. Government Printing Office, 1983), pp. 68-70.

[14]See, for example, Axel Lebahn, "Financing German Trade With the East, " *Aussenpolitik*, vol. *33, 1982*, p. 129,

[15]*Premises of East- West Commercial Relations,* op. cit., pp. 70-71.

[16]U.S. Congress, House Committee on Foreign Affairs, Subcommittee on Europe and the Middle East, An *Assessment of the Afghanistan Sanctions: Implications for Trade and Diplomacy in the 1980s,* Committee Print, 97th Cong., 1st sess., April 1981 (Washington, D. C.: U.S. Government Printing Office, 1981), pp. 106-108.

[17]U.S. Congress, Senate Committee on Barking, Housing, and Urban Affairs, Subcommittee on *International Finance and Monetary Policy, International Affairs Functions of the Treasury and the Export Administration Act,* hearings, 97th Cong., 1st sess., Apr. 30, 1981 (Washington, D. C.: U.S. Government Printing Office, 1981), pp. 19-21.

[18]Testimony of Ernest B. Johnston, Deputy Assistant Secretary of State for Economic and Business Affairs, before the House Committee on Foreign Affairs Subcommittees on International Economic Policy, and Trade and on Europe and the Middle East, May 25, 1982, mimeo., p. 12.

[19]*International Affairs Functions,* op. cit., p. 18. The estimate is by the OECD staff.

- limit subsidized credits by raising the interest rate charged, requiring larger downpayments, or limiting the share of a project that could be financed through official credits;
- establish a mechanism to monitor a program for reducing subsidized credits;
- place the Soviet Union in a separate category for all economic relations and coordinate the flow of Western credits to it; and
- place a temporary moratorium on credit to the Soviet Union while credit issues were discussed.[20]

The U.S. team was not able to achieve its goal of securing an agreement before the Versailles economic summit, and the attitude of the French Government was widely thought to have been the major barrier. At U.S. insistence, the issue was placed on the summit agenda. Although undoubtedly weaker than the United States had hoped, language on credit was included in the communique issued at the end of the meeting. It read as follows:

> . . . taking into account existing economic and financial considerations, we have agreed also to handle cautiously financial relations with the U.S.S.R. and other Eastern European countries in such a way as to ensure that they are conducted on a sound economic basis, *including also the need for commercial prudence in limiting export credits*. (Emphasis added.)

The participants also agreed to exchange information in OECD on credits and other aspects of commercial relations with the East. As was described in chapter V, whatever partial consensus achieved here was challenged less than 2 weeks later by French President Mitterrand, who rejected the idea of limiting credits to the Soviet Union.

Mitterrand's statement notwithstanding, the participants in the OECD Arrangement, including France, did agree to changes which effectively raised the minimum interest rate charged the Soviet Union to 12.15 percent. This was accomplished by changing the U.S.S.R.'s classification from "intermediate" to "relatively rich" and by raising minimum interest rates for groups of countries in these categories. The new interest rates, which went into effect on July 5, 1982, are shown in table 10.

Administration officials have expressed satisfaction with the revised OECD agreement, but the United States did not achieve all that it sought.

[20]Christopher Madison, "East-West Trade okay, Says U. S., But It Shouldn't Be on the Cuff, " *National Journal*, Aug. 21, 1982, p. 1464 and John Plender, "East-West Trade: An End to Business as Usual, " *Economist*, May 22, 1982, pp. 70, 72.

Table 10.—Minimum Interest Rates Under the OECD Arrangement[a]

	2 to 5 years	Over 5 to 81/2 years	Over 81/2 to 10 years
Relatively rich	12.15	12.40	N/A[c]
Intermediate[b]	10.85	11.35	N/A[c]
Relatively poor . . .	10.00	10.00	10.00

a These rates do not apply to off!cial credits in yen nor to credits for exports of certain aircraft or nuclear powerplants

b From July 5 to Dec 31, 1982, there were different rates for countries that had previously been in the intermediate categories and those that had been "graduated" from poor to Intermediate.

c Relatively rich countries and "old" intermediate are ineligible for credits over 81/2 years "New" Intermediate countries remain eligible for credits up to 10 years.

SOURCE Export-Import Bank

In addition, some are skeptical about compliance, They assert that it is easy for a country to circumvent the agreement by lowering the price charged for equipment while offering the agreed interest rate, or by "grandfathering" a credit agreement.

The Polish Debt

At the end of September 1982 Poland's debt to the West was estimated at $25 billion, of which some $17.5 billion is owed to Western governments or is guaranteed by Western governments. About $7.5 billion is private, unguaranteed debt. As table 11 demonstrates, U.S. entities hold a relatively small share of Polish debt,

The United States and other Western countries rescheduled official Polish credits falling due in 1981, but, in response to the declaration of martial law in Poland, declined to reschedule debts falling due in 1982. At a meeting in early January 1982, the NATO ministers agreed not to reschedule these debts, which are thought to total about $10 billion, until the situation in Poland was normalized. President Reagan has set three conditions for U.S. rescheduling of Poland's official 1982 debts: 1) an end to martial law, 2) release of political prisoners, and 3) resumption of the Government's dialog with Solidarity and the Church. The administration does not consider the Polish Gov-

Table 11 .—Poland's Debt to the United States, as of September 1982 (billion U.S. dollars)

Nonguaranteed loans by private creditors (primarily commercial banks)	$1.197
Direct credits and guarantees from CCC	1.701
Export-Import Bank loan	0.247
AID loan	0.006
Total	$3.152

SOURCE U S Department of Treasury Off Ice of East-West Economic Policy ernment's decision to lift martial law in December 1982 sufficient, particularly since many martial law restrictions were added to the legal code. While Poland's official debts for 1982 have not been rescheduled, it did reach a rescheduling agreement with commercial banks for debts falling due in 1982.

To avoid a formal default on the loans guaranteed by the Commodity Credit Corporation (CCC), the Reagan administration issued emergency regulations on January 29, 1982. Under the old CCC regulations, a bank seeking reimbursement for an agricultural credit guaranteed by the Corporation had to issue a "notice of default." Under the new regulations, CCC could reimburse the bank without this notice. Without a formal declaration of default, other holders of Polish debt would not be able to invoke the cross default provisions of their loan agreements or to start legal proceedings to seize Polish assets. Some Members of Congress and others criticized both the manner in which the change was introduced and the Reagan administration's decision not to declare an immediate default.

Advocates of forced default have charged that allowing CCC to cover loan guarantees amounts to a "bail out" of bankers who made unwise loans and a subsidy for a repressive regime. In their view, a declaration of default on CCC obligations, which would probably be followed by a default on all Polish debts, might compel the Soviet Union to cover Poland's debts. In this case, the result might well be fewer resources available for the Warsaw Pact. Those officials opposed to forcing a default argue that Poland is under more pressure since it is making some, albeit small, repayments and that it would have no incentive to repay if a formal default were declared. In their view, the latter situation would effectively vitiate Western influence in Poland and might have serious financial repercussions for West European banks and for Western governments, which would have to pay billions on guaranteed loans. They also argue that unilateral action by the United States would probably compromise U.S. efforts to forge allied consensus on the issue and might well strain the alliance.[21]

A test of congressional opinion on forced default came during the summer of 1982, when congressional advocates of forced default succeeded in adding a provision to the Supplemental Appropriations Act of 1982 (Public Law 97-257), which prohibits the use of funds to reimburse U.S. banks for loans guaranteed by the Government unless it declares Poland in default or unless the President provides Congress with a monthly written explanation of how not declaring Poland in default advances the U.S. national interest. This provision, which was introduced by Senator Helms, applies to fiscal year 1983. It represents a continuation of a similar amendment to the Urgent Supplemental Appropriations Act of 1982 (Public Law 97-216), which was introduced by Senator Kasten and applied to fiscal year 1982.

The Polish debt issue is only temporarily in abeyance. Absent liberalization by the Polish regime or a change in Western policy, Poland's official debts falling due in 1982 and 1983 will not be rescheduled. Thus, formal default remains a possibility, although pressures to reschedule are likely, especially if the Polish regime shows signs of liberalizing its policies. Some argue that rescheduling could benefit the West if economic or political conditions were attached.

[21] For a more detailed analysis of the arguments pro and con, see U.S. Library of Congress, Congressional Research Service, Office of Senior Specialists, *Rescheduling the Polish Debt*, Issue Brief No. 82082, Jan. 27, 1983 [prepared by John P. Hardt and Donna L. Gold], pp. 5-6.

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