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THE COSTS TO THE UNITED STATES ECONOMY THAT WOULD RESULT FROM REMOVAL OF CHINA'S MOST FAVORED NATION TRADE STATUS

EXECUTIVE SUMMARY[1/]

Removal of China's most favored nation status would cause great harm to U.S. consumers, businesses and workers. U.S. consumers would pay as much as $10 billion annually as a result of higher prices on a wide range of goods in the U.S. market. In addition, as a result of the likely Chinese retaliation against U.S. exports, 100,000 jobs in U.S. firms exporting to China would be at risk, as would U.S. exports of nearly $5 billion and U.S. investments in China estimated at approximately $4 billion.

I. Removal of China's MFN Status Would Cost U.S. Consumers As Much As $10 Billion

If China lost MFN status, the duty paid cost of most Chinese goods in the U.S. would increase in the range of 10.0 to 70.0 percent, with most of the increases exceeding 20.0 percent. Should this occur, imports of nearly all items from China would be reduced or entirely eliminated and U.S. consumers would then have to pay as much as $10 billion for the remaining imports from China which

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1/ Copies of the full report may be obtained by request to IBERC. There will be a charge of $8 to cover printing, mailing and handling charges.

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would be assessed extremely high non-MFN tariffs as well as higher prices from other suppliers whose products would replace Chinese imports.

As specific examples of cost increases, the duty-paid price of silk blend and other vegetable fiber sweaters from China would increase from $117.12 to $176.78 per dozen and tariffs on toys would increase from 6.8 to 70.0 percent.

A specialized economic model was used to analyze how trade would be affected and the subsequent costs to consumers should China lose MFN. The model, known as CADIC, was developed by the U.S. International Trade Commission and is used to analyze the effect of changes in price on trade in particular products. In this case, the model was used to calculate the shift in demand away from China to other sources resulting from the increased price of imports from China. Data on those products, which constitute the largest share of the value of U.S. imports from China, was provided as input to the model. Output from the model was extrapolated to include all U.S. imports from China and cost increases as products move through the U.S. distribution system. Based on these calculations, consumer costs would increase between $6.9 and 9.9 billion due to the combination of a shift to higher priced sources of supply and higher prices for the remaining imports from China. It is important to note that the calculated consumer costs would have even been higher if we had not factored in the assumption that 25 percent of the cost increase would be

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absorbed by the exporter and/or importer and not passed along to the consumer.

To relate this cost directly to the U.S. economy, $10 billion equates to an average of $109 per year on each of the 92 million U.S. households. From another perspective, $10 billion equals the total 1990 budget of states such as Connecticut and Minnesota and exceeds the combined total spent by Idaho, Montana, Utah and Wyoming in 1990.

II. 100,000 U.S. Jobs Are At Risk Should China Lose MFN Status

Should China lose MFN and retaliate by restricting imports from the United States, approximately 100,000 U.S. jobs would be at risk. This figure is based on U.S. exports to China of $5 billion coupled with a U.S. Department of Commerce preliminary estimate that an average of 19,100 U.S. jobs are created for each billion dollars of exports.

The Commerce Department employment estimate included direct employment in the export industry as well as all of the upstream and downstream production and services necessary for the production and export of finished products. On average, for each job directly generated by exports, two more are indirectly created.

It is difficult to predict how many of the estimated 100,000 U.S. jobs created by exports to China would be lost. In all likelihood, job loss would vary in terms of time frame and product. However, the Chinese have given clear evidence that they will

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retaliate against U.S. exports. For example, China's grain purchases from the United States fell from 5 million tons in 1973/1974 to nothing in 1976 and 1977 reflecting China's dissatisfaction with the slow pace of American moves to normalize political relations with China.

Export losses can even be expected on commercial aircraft despite the assumption that continuity in terms of aircraft types, training, spare parts, etc. would favor ongoing purchases of U.S. airplanes.

Thus, with China's clear readiness to retaliate against U.S. exports, combined with the availability of competitive substitutes from other countries, it is safe to say that a high proportion of the 100,000 U.S. jobs associated with exports to China would be lost.

III. U.S. Exports to China Would Drop Should China Lose MFN Status

China's leaders have stated clearly that there would be retaliation against U.S. exports should China lose MFN status, and U.S. exports amounting to approximately $5 billion would be vulnerable. While U.S. exports to China declined in 1990, they have increased by 18.1 percent during the first six months of 1991 compared to the same period in the prior year, and it is expected that China's rapidly growing needs for raw materials and technology will offer significant export development opportunities in both the long and short term.

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Looking at the list of major exports to China, it is apparent that several sectors of the U.S. economy could be hurt should exports to China be curtailed. In particular, the U.S. aircraft industry's share of China's aircraft market, estimated at $10-15 billion over the next 10 years, could be seriously compromised should China lose MFN status.

Major U.S. Exports to China, 1990

Commodity	Value (million dollars)
Aircraft and Parts	749
Fertilizer	544
Wheat	497
Chemicals	345
Cotton	277
Wood in the Rough	171
Parts for Machinery	114
Automatic Data Processing Machines	113
Machines Having Individual Functions	97
Artificial Filament Tow	88
Turbojets, Turbopropellers and Other Gas Turbines	88
Uncoated Kraft Paper and Paperboard	73
Copper Ores and Concentrates	50
Electric Generating Sets and Rotary Converters	44
Oscilloscopes, Spectrum Analyzers, etc.	42
Total, this list	$3,292 million
Total U.S. Exports to China	$4,775 million

Should the United States' exports to China be curtailed, U.S. products and services will be replaced by those of competing countries. As a result, the United States' competitive position throughout Asia will be weakened as the scale of operations of other countries in that region will increase.

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IV. Potential Loss to U.S. Investors Should China Lose MFN Status

It is estimated that direct investment by U.S. firms in China amounts to approximately $4 billion, representing 1,000 or more individual projects. Revoking China's MFN status would jeopardize the invested capital as well as the future earning potential of these investments.

Withdrawal of MFN would also intensify the existing difficulties faced by U.S. firms' joint ventures in China. Following removal of MFN, China might impede or completely frustrate operations of these firms by restricting access to imported inputs and by increasing existing bureaucratic controls over these operations. In addition, U.S. firms which produce in China for the U.S. market would be unable to export products to the U.S. due to the assessment of extraordinarily high non-MFN tariffs.

Although U.S. investments benefit China, there can be little doubt that they could become targets of Chinese retaliation should MFN status be removed. China's ambassador to the United States, speaking of U.S. investment in China, threatened, "Put any conditions on extending most favored nation treatment for China and that economic progress may well end."

Meanwhile, Hong Kong, Japan, Taiwan and Western Europe are markedly expanding their presence in China through direct investment and provision of credit. Removal of MFN by the United States could undo 10 years of development by U.S. firms in China and severely restrict the ability of many U.S. firms to compete in

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a global marketplace by leaving the China market open to America's aggressive, international competitors.

V. *China's Current Trade Status Is Not "Most Favored" As It Is The Same Accorded To All But A Handful Of Countries*

The United States has two sets of tariff rates. The lower of the two is correctly termed "General" but is also referred to as most-favored-nation or "MFN." Imports from over 200 countries and territories are assessed at the General or MFN duty rates. In contrast, only eight countries are not now accorded General tariff status and are not under consideration to receive General tariff status in the near future. Imports from these eight countries[1/] face "Column 2" tariff rates which mainly range from two to ten times higher than General rates.

To illustrate the huge difference between General and Column 2 tariffs, 1990 imports from China of $15.12 billion were assessed General tariffs of $1.23 billion, an average duty rate of 8.13 percent. If the same imports were assessed Column 2 rates, $6.73 billion in tariffs would have been assessed, an average duty of 44.5 percent.

While China is accorded the same General tariff rates as nearly all other countries, it is disadvantaged compared to most developing countries which are able to export a wide range of

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1/ Afghanistan, Albania, Cambodia, Cuba, Laos, North Korea, Romania and Vietnam.

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products to the United States duty-free under the Generalized System of Preferences (GSP) or the Caribbean Basin Economic Recovery Act (CBI). China is ineligible for these programs which provide significant cost advantages to China's competitors on a wide range of products.