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Sino-Japanese Trade in the Post-Normalization Era

by David Leng* & Shao-chuan Leng**

The passage of the Sino-Japanese Long-Term Trade Agreement in early 1978, followed closely by the signing of a Peace and Friendship Treaty, has resulted in a virtual explosion of trade between the two nations. The authors examine the current results flowing from this recent expansion in dealings between the People's Republic of China and Japan, with special emphasis on the importance of pre-existing ideological and technological differences in the agreement-negotiating process. The authors conclude with an examination of the future impact of both agreements, in terms of their foreseeable effect on global trade and competition.

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I. INTRODUCTION

UPON THE NORMALIZATION of the diplomatic relations between Japan and the People's Republic of China (PRC) on September 29, 1972, a new era in Sino-Japanese trade was ushered in. Immediately the amount of two-way trade climbed to around $1.1 billion in 1972,1 zooming to $3.3 billion in 1974 and $3.8 billion in 1975,2 before plummeting to $3,033,483 in 1976 and then recovering to reach $3,485,987 in 1977.3 Prospects for 1978 are extraordinarily favorable with figures on the first half of the year showing Sino-Japanese trade at $2,138,808, an all-time high for such a period.4

The volume of Sino-Japanese trade over the last six years has been strongly influenced, as has all of the PRC's commercial activity, by domestic unrest and the vicissitudes of an internal ideological conflict. This article proposes to examine the fluctuations in Sino-Japanese trading patterns in the 1972 to 1978 period, with the focus first on the structure and nature of the trade before the signing of the Sino-Japanese Long-Term Trade Agreement in February of 1978, and then on the explosion in this trade since the Long-Term Trade Agreement, which appropriately coincided with the signing of the Sino-Japanese Peace and Friendship Treaty in August of 1978. Great attention will be devoted to the shift in the PRC's thinking from a more doctrinaire form of "self-reliance" championed by the "Gang of Four," Mao Tsetung's putative heirs, to the pragmatism of the Chou En-lai and Teng Hsiao-ping political philosophy exemplified by its "Four Modernizations" program and the desire to import vast quantities of foreign technology.

In view of its crucial role in the Long-Term Trade Agreement, the future of the PRC's oil industry will be considered along with the still festering dispute between China and Japan over the potentially rich petroleum deposits in the East China Sea around the Tiao Yu-t'ai (also called Senkaku) Islands. Another indispensable element in the Long-Term Trade Agreement, the Japanese exportation of industrial plants and equipment to the PRC, will be scrutinized, especially those dif-

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1 Tsuchiya, Recent Developments in Sino-Japanese Trade, 38 LAW & CONTEMP. PROB. 240 (1973).
3 CHINA NEWSLETTER 16 (April 1978) (published by the Japan External Trade Organization).
4 Id. at 32 (September 1978).
ficulties encountered in the transfer of technology, such as developed by the Coordinating Committee (COCOM) of the multilateral Consultative Group (CG), and the question of patent rights. Other key commodities in Sino-Japanese trade also will merit some discussion. A further topic of investigation will be the various methods the Chinese will employ to finance their extensive import program.

II. RECENT TRENDS IN THE PRC'S FOREIGN TRADE

The PRC's foreign trade picture has been characterized by "the rapid expansion of the 1950's, the slowdown of the 1960's, and the era of resurgence, of the 1970's." Forced to retrench in the 1960's in the face of the ideological split with the Soviet Union, and the domestic anarchy generated by the Cultural Revolution, Chinese trade dropped in net volume from the previous decade. In contrast, 1970 through 1976 saw the value of the PRC's foreign trade grow more than twenty percent a year in terms of current prices. Between 1970 and 1975, industrial output increased at an estimated annual rate of ten percent, while in dollar value, China's foreign trade increased from $4.72 billion in 1971 to $14.32 billion in 1975. Purchases from the industrialized Western countries, including Japan, accelerated in value from $1.221 billion in 1970 to $4.591 billion by 1975, with Western imports comprising 63.7% of the Mainland's total imports that year.

This quadrupling of trade activity with the West and the general improvement in economic productivity occurred at a time when Chou En-lai's plea for "modernization" and an end to China's self-imposed isolationism began to have significant impact. But abruptly in 1976, China experienced a drastic slump in economic activity. According to one estimate, the dollar amount of the PRC's foreign trade fell to between $13.1 and $13.4 billion in 1976, a drop of six to eight percent from the 1975 figures. In its burst of enthusiasm to develop more ties with the outside world, Peking had managed to build up a trade deficit of almost $1.5 billion in the 1973 to 1975 period. Of particular importance in this deficit was the Japanese accumulation of a surplus

6 Id.
10 Hsia, supra note 8, at 93.
approaching $730 million by the end of 1975. One can view 1976 as the year in which the Chinese leadership attempted to restore a favorable trade situation, since a negative trade balance is an anathema to the PRC, indicating undue dependence on foreign powers. Also, in practical terms, the reduction in imports in 1976 was "necessary to provide the PRC a breathing spell during which to absorb the massive purchases of the previous years." China's economic slowdown in 1976 was exacerbated by the horror of the Tangshan earthquake in July of 1976, which had a traumatic effect on overall productivity. The Tangshan catastrophe ruined coal production at Kailuan, the chief source of coking coal for the steel industry. A decline in steel output meant that the Japanese were able to purchase in 1976 only about 3.5 million tons of steel products as opposed to the original prediction of six million tons. Finally, the atmosphere of domestic instability, which was climaxed in October by the purge of the Gang of Four, contributed greatly to China's poor economic performance in 1976. In any event, Japan's exports to the PRC in 1976 fell 26.4% below 1975, and its imports from the PRC suffered a corresponding decline of 10.5%.

Chinese economic growth surged upward in 1977 with industrial production increasing by fourteen percent over 1976 levels. Some comparisons help highlight the degree of industrial recovery in 1977: Iron and steel production reached twenty-three million tons versus slightly below twenty-one million tons in 1976; 443 million tons of coal were mined in 1976, compared to 500 million tons the next year; and petroleum output rose from eighty-six million tons in 1976 to ninety-three million tons in 1977.

Sino-Japanese trade in 1977 was characterized by a sluggish and discouraging first half and a remarkable upturn in the second half, especially in Japan's exports. The two-way trade totalled only $1.5 billion in the January to June period, a ten percent decline even from the first half of 1976. Trying to rectify the unfavorable trade balance with Japan, China's imports from Japan were reduced by a staggering 26.2%.

11 ORIENTAL ECONOMIST, November 1976, at 23.
12 Hsia, supra note 8, at 94.
13 See ORIENTAL ECONOMIST, November 1976, at 23.
14 CHINA NEWSLETTER 16 (April 1978).
16 CHINA NEWSLETTER 30 (September 1978).
17 Id. at 4 (October 1977).
from the first half of 1976, while its exports increased 17.6%. By the end of 1977, the Sino-Japanese bilateral trade had grown 14.9% over 1976 with imports from Japan up 16.6% (about $1.94 billion), an extraordinary recovery considering the first half drop of 26.2%. Japanese imports also were up 12.9% to $1.547 billion, the highest figure ever reached in Sino-Japanese trade.

Despite a positive change from the gloomy figures of 1976, the PRC's total foreign trade volume in 1977 barely attained the level of 1975. Though the twelve percent increase in trade over 1976 was impressive, the average annual growth rate in the years 1970 through 1975 was twenty-one percent. Furthermore, contracts for complete plant imports declined from $185 million in 1976 to only $59 million in 1977. The preparatory phase initiating those complicated economic adjustments required to increase the amount of future imports began in 1977. Implementation of Peking's new expansionist trade policies only gathered momentum later in the year, evidenced by the great jump in the volume of Sino-Japanese trade in the second half of 1977.

Of course, the first half of 1978 has seen an unprecedented growth in Sino-Japanese trade, based on the terms of the Long-Term Trade Agreement and bolstered by the signing of the Peace and Friendship Treaty. Japan's exports recorded an all-time peak of $1,235.21 million, improving 56.1% over the comparable 1977 period. The period was marked by substantial sales of iron and steel, coupled with a sharp rise in machinery and equipment purchases by the PRC. Moreover, Japanese imports from China also reached a record figure of $903.6 million, a 27.6% increase over the first half of 1977. It has been estimated that in the first half of 1978 alone, the PRC committed itself to more than five billion dollars worth of capital imports (plants and equipment), while only approximately $2.78 billion in such imports

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18 Id.
19 Id. at 9 (April 1978).
20 Yeh, Foreign Trade Under the Hua Regime: Policy, Performance, and Prospects, in PROCEEDINGS OF THE SEVENTH SINO-AMERICAN CONFERENCE ON MAINLAND CHINA 2 (Institute of International Relations, National Chengchi University ed. 1978).
21 Id. at 5.
22 CHINA NEWSLETTER 1 (September 1978).
23 Id. at 2. By the end of the third quarter the total volume was worth a little more than $3.4 billion, an increase of 38.4% over the corresponding 1977 period with Japan enjoying a significant $590.25 million surplus. Id. at 6 (December 1978).
were ordered during the years 1973 through 1977. Financing for this buying spree has been facilitated by the PRC’s accumulation of a trade surplus of over two billion dollars during 1976 and 1977.

III. IDEOLOGICAL BACKGROUND OF THE PRC’S SHIFT IN TRADE POLICIES IN THE 1970’s

In view of the present government’s modified and flexible interpretation of self-reliance and modernization, the infatuation with Western technology and economic organization has far-reaching implications for Peking’s foreign trade prospects. Although the PRC is now eager for Western assistance, it has not abandoned completely its own particular version of economic development. Self-reliance, in the eyes of the Teng Hsiao-ping and Hua Kuo-feng regime, still means a fundamental preference for domestic products over imports.

Imports are to be confined to commodities essential to national security, to economic development or to the subsistence of the people; they do not include non-essential consumer goods. The primary objective of PRC exports is to finance necessary imports rather than to augment employment or the growth of the domestic economy.

Foreign trade is just a means to an end—a necessary evil enabling China to chart a course of independent economic growth. One indication of how rapidly Chinese thinking is changing is some preliminary evidence that Peking has even decided to import consumer items as a way of raising the standard of living and providing the people with more types of material incentives.

The Chinese modernization entails a “shift away from do-it-yourself, local labor-intensive, low-skill industrialization toward large, capital and skill-intensive, technologically advanced complexes” with priority given to heavy industry. Re-focusing its policy of technical

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24 FAR EAST. ECON. REV., October 6, 1978, at 45.
25 CHINA NEWSLETTER 9 (April 1978). See also FAR EAST. ECON. REV., July 7, 1978, at 34, stating that Peking’s foreign reserves in light of these surpluses now were valued at around four and five billion dollars divided about equally between gold and hard currency.
26 Chou, supra note 5, at 66.
27 FAR EAST. ECON. REV., September 15, 1978, at 65-66. There was a relaxation of import restrictions on luxury items such as cameras, televisions and watches although they are still subject to heavy import duties.
28 Prybyla, supra note 15, at 64. For a description of China’s “Four Modernizations” program, see NEWSWEEK, November 20, 1978, at 70.
dualism known as "walking on two legs," the PRC has moved from the indigenous "leg" of technology, commonly referred to as "appropriate technology," to the "leg" of borrowing technology from more highly developed societies. This Chinese emphasis is ironic because the current mood in many other developing nations favors concentrating on "appropriate technology," since it is considered less imitative and more responsive to each individual country's unique social, political and economic environment. Peking's present form of modernization has as its inspirational and doctrinal source Chou En-lai's report to the Fourth National People's Congress in January 1975, outlining two stages of development for China. Before 1980, China is to have "an independent and relatively comprehensive industrial and economic system" in order for the country to take its place among the global powers. The second stage requires "the comprehensive modernization of agriculture, industry, national defense and science and technology."

Teng Hsiao-ping was a fervent disciple of Chou's Four Modernizations program, but he was ousted from power in April of 1976, shortly after Chou's death, by the radical Maoist elements led by the Gang of Four. For a brief period from April through October of 1976, the Gang of Four promoted the dominance of the "red" over the "expert" factions in Chinese politics. Their opening salvo directed against the moderate forces symbolized by Teng was a February 6, 1976 People's Daily editorial, lambasting Teng for endeavoring to subvert the legacy of the Cultural Revolution. Teng was ridiculed for forsaking the masses, since he assigned no prominent place in his modernization plans to the creative will of the people. He was accused of squandering China's precious raw materials and exchanging them for high-priced capitalist goods, thereby relegating China to semi-colonial status once again. Indiscriminately importing "foreign things," according to Study and Criticism, a Shanghai mouthpiece of the Gang of Four, would only lead to a deplorable state of affairs in which the PRC would "become nothing more than a market where the capitalists could dump their goods, a source for their raw materials, a repair and assembly facility for them, somewhere they could invest for huge profits . . . ."

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29 Chen, supra note 7, at 30-31.
30 Morrison, supra note 9, at 692.
31 ORIENTAL ECONOMIST, May 1976, at 3.
32 Morrison, supra note 9, at 694-95.
Especially virulent were the radicals' denunciations of Teng's so-called "Twenty Points" philosophy, which had been expressed in a report entitled, "Some Problems in Conjunction with the Quickening of the Development of Industry." Under the tutelage of Teng, this document was supposedly drafted by such eminent Communist Party officials as Li Hsien-nien and Yu Chiu-li in August and September of 1975.\textsuperscript{3} It is not unreasonable to suggest that the Twenty Points is "as succinct and cogent a case for economic development . . . as has emerged from the PRC."\textsuperscript{34} Twin goals were proposed in the Twenty Points; the large-scaled adoption of foreign technology, and a corresponding increase in mineral exports to help defray the high costs of importing such advanced technology. Contained in the Twenty Points was a description of "product payback," a novel financing mechanism:

In order to hasten the exploration of our coal and petroleum, it is possible that on the condition of equality and mutual benefit, and in accordance with accepted practices of international trade such as deferred and installment payments, we [the Chinese] may sign long-term contracts with foreign countries and fix several production sites where they will supply complete sites of modern equipment required by us, and we will pay for them with the coal and oil we produce.\textsuperscript{35}

The principles underlying this exchange scheme were to reemerge within the context of the Sino-Japanese Long-Term Trade Agreement. Following Mao's death the reversal of the radicals' positions began almost immediately upon the arrest of the Gang of Four and the designation of Hua Kou-feng as Communist Party Chairman in October 1976. Suddenly, foreign trade was praised as an integral part of China's economic activity. Serving as ready-made scapegoats, the Gang of Four were blamed for all of the country's economic woes. According to Hua, their xenophobia and total rejection of needed foreign assistance ended up costing the PRC, between 1974 and 1976, about $61.3 billion in industrial output, twenty-eight million tons of steel and around $24.5 billion in state revenues.\textsuperscript{36} These alleged renegades were charged with paralyzing China's foreign trade apparatus by behaving arbitrarily and irrationally in decision-making positions while ignoring central directives unsympathetic to their purposes.\textsuperscript{37}

\textsuperscript{33} China Newsletter 2 (October 1977).
\textsuperscript{34} Morrison, \textit{supra} note 9, at 696.
\textsuperscript{35} Id. at 693-94.
\textsuperscript{36} Far East Econ. Rev., March 17, 1978, at 42.
\textsuperscript{37} Hsia, \textit{supra} note 8, at 99.
also were viewed as the chief culprits in perverting the PRC's normal commercial practices.

With a view to undermining our country's exports, the "gang of four" also made a host of accusations and created confusion with respect to pricing, trade practices, managerial procedures and many other problems. When you improved the quality, variety, design and packaging of export commodities in order to suit the customs and habits and level of consumption of other countries and nations and to meet the needs of the international market, they attacked you for "waiting on the foreign bourgeoisie."

Accompanying this disturbing drop in quality was growing international uneasiness over the reliability of Chinese products. In 1978, the PRC was particularly anxious to arrest this trend of deterioration, for it is clear that "without quality, products are merely a pile of junk and the value of output is not worth a penny."

Arguably the most damning indictment of the Gang of Four was their malicious conspiracy to sabotage China's oil production capabilities. They disrupted the State's oil allocation plans by falsely diverting needed supplies away from outlying areas to Shanghai and Liaoning Province. Additionally, they also were guilty of changing the "coal-consuming enterprises into oil-consuming enterprises with the ulterior motive of deliberately creating a situation in which there was an urgent need for oil."

To buttress their counteroffensive against the Gang of Four the moderates evoked the wisdom of the two icons of world communism, Mao and Lenin. Reference was made to Mao's 1956 polemic, "On the Ten Major Relationships," which extolled the virtues of tolerance and open-mindedness in plotting China's course of economic development. Selective importation of foreign technology was compatible with self-reliance, since Mao believed that,

[O]ur policy is to learn from the strong points of all countries, learn all that is generally good in the political, economic, scientific, and technological fields and in literature and art. But we must learn with an analytical and critical eye, not blindly, and we must not copy everything indiscriminately and transplant mechanically.41

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38 Id. at 100.
39 Quoted from the Communist Party journal, Red Flag, reprinted in FAR EAST. ECON. REV., August 11, 1978, at 86.
40 Hsia, supra note 8, at 98-99.
41 Morrison, supra note 9, at 700.
Moreover, Mao's hoary principle, "Develop the Economy and Ensure Supplies," first expressed in 1942, was utilized by Hua as a call for increased production and economic growth which necessarily meant more foreign commerce.\textsuperscript{42} As for Lenin's opinions, Peking went as far as quoting with approval the infamous Stalin comments on Lenin's viewpoint in 1921 when the Soviet Union was still a struggling infant nation: "He [Lenin] recognized therefore at that time that the best among all the feasible measures which would be taken was to attract foreign capital, to use it for the development of industry."\textsuperscript{43} \textit{Peking Review}, in its October 13, 1978 issue asserted that "[s]cience and technology have no class nature," and cited Lenin, who conceded that in restoring the Soviet economy, "we should not grudge the capitalist a little extra profit if only we can effect this restoration."\textsuperscript{44}

At the 11th Chinese Party Congress, held in August 1977, the preamble of the new party code accepted the four modernizations program as the basic guiding policy for China's economic development.\textsuperscript{45} Symbolically, this statement coincided with the return to power of Teng, also in August of that year. Using the four modernizations as their rallying cry, the Teng-Hua leadership convened the National Finance and Trade Conference on Learning from Taching and Tachai in Peking from June 20 to July 9, 1978. Specific appeal was made to the masses for their support and participation in this new "Long March."\textsuperscript{46} Both Hua and Li Hsien-nien further catalogued the economic harm and corruption caused by the excesses of the Gang of Four. Hua acknowledged the importance of the proper use of the "law of value," an euphemistic term for profit. Running businesses for personal gain had been regarded by the radicals as "putting profits in command," and they had instead adhered to the "reactionary view that it was glorious to run an enterprise at a loss."\textsuperscript{47} Such an unenlightened attitude made it extremely difficult to live up to Mao's adage of "developing the economy and ensuring supplies," since no individual incentives to produce were recognized. Economic growth could now be crucially abetted by foreign trade, because in Li's colorful biological analogy, "Just as a person cannot survive without the circulation of blood, so our socialist economy cannot for a moment

\begin{footnotes}
\item \textsuperscript{42} \textit{Peking Rev.}, July 28, 1978, at 8-9.
\item \textsuperscript{43} \textit{Far East. Econ. Rev.}, September 22, 1978, at 35.
\item \textsuperscript{44} \textit{Peking Rev.}, October 13, 1978, at 13.
\item \textsuperscript{45} \textit{China Newsletter} 1 (October 1977).
\item \textsuperscript{46} \textit{Peking Rev.}, July 28, 1978, at 3.
\item \textsuperscript{47} \textit{Id.} at 11.
\end{footnotes}
operate without financial and trade work, the exchange of commodities or the allocation of funds." Foreign trade is a lifeline in maintaining the PRC's economic health, underscoring Peking's new tacit admission that the world has become an interdependent marketplace.

An important argument advanced by the Teng-Hua moderates for importing technology is the pressing timetable for modernization. China cannot afford any more delays although "the Chinese people can certainly make scientific and technological inventions and creations as well as foreigners and may even surpass them in some respects . . . . There is a problem of racing against time, for speed." While somewhat defensive in tone, this praise of the Chinese innate talent for scientific originality and discovery has been an important psychological theme during the present period of headlong assimilation of Western technology. To positively reinforce their self-image the Chinese have subscribed to a cyclical view of technological progress:

Science and technology are wealth created by all mankind. Every nation, every country must learn the strong points and advanced science and technology from other countries. The better one learns, the bigger the progress. China's four inventions of ancient time—papermaking, printing, gunpowder and the compass—were new techniques which many countries took over and used. . . .

There is an historical linkage and continuity in technological development; China has a rich heritage of scientific achievement which it gave the "barbarian" West; now it is only fitting and fair for China to be paid back.

Significantly, Japan was suggested as a paradigm for the PRC's development strategy. The Japanese policy of obtaining foreign patent rights and molding the technology to suit their own special requirements contributed mightily to their economic miracle by transforming Japan's industrial infrastructure almost overnight. Such unabashed admiration for the Japanese modernization experience certainly was an important impetus behind the revolution in Sino-Japanese trade relations in 1978. On his visit to Japan in October of 1978 to sign the Peace and Friendship Treaty, Teng declared that his primary purpose was to "learn from the . . . Japanese people." In

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48 Id. at 16.
49 Hsia, supra note 8, at 101.
51 Id.
addition, there is a natural historical and cultural affinity binding the two countries together.

In Japan the Chinese find lessons in efficiency and enterprise not so tainted by the rugged individualism they find so distasteful in the West. Japan suggests a way to build modern factories without losing too much of traditional arts and a way to borrow from the West without being controlled by it. Japan offers economic vitality without immense income differences or social schisms. It insists on a respect for elderly leaders that sits well with China's current gerontocracy.53

A practical catalyst for the enormous broadening of Sino-Japanese economic ties in 1978 was the ambitious Ten Year Development Plan unveiled by Hua at the 5th National People's Congress held from February 26 to March 5, 1978. Originally written in the summer of 1975, this plan was temporarily shelved because of the machinations of the Gang of Four. Therefore, the Plan encompassed the period 1976 to 1985 by also absorbing the Fifth (1976-80) and Sixth Five Year Plans (1981-85).54 Designed to make the goals of the four modernizations campaign a reality by the end of this century, the Ten Year Development Plan fixed some very grandiose economic targets. In the area of basic construction, 120 major projects were envisioned, including ten iron and steel plants, nine nonferrous metal plants, eight coal mines, ten oil and gas fields, thirty power plants, six new railroad lines, and five ports and harbors. Investments in these new projects were to be equivalent to all such similar expenditures made in the past twenty-eight years. Industrial production was supposed to expand at an annual rate of over ten percent, agricultural growth was set at four to five percent a year with food output to reach 400 million tons annually, and mechanization of agriculture was to cover eighty-five percent of all farming tasks. In the realm of science and technology, 800,000 scientists were to be trained, while several centers for scientific experimentation were to be coordinated into a nationwide research system.55

On March 18, 1978, Fang Yi, the minister in charge of the State Scientific and Technology Commission, delivered a speech at the National Science Conference delineating in more detail the technical needs of the country. He listed twenty-seven critical fields of

53 Id.
54 CHINA NEWSLETTER 21-22 (September 1978).
55 For other details of the Ten Year Plan, see id. and FAR EAST. ECON. REV., March 17, 1978, at 41-42.
technological development with 108 key projects, while also confessing that China was lagging fifteen to twenty years behind the world leaders in many areas.\textsuperscript{56} To even partially fulfill the economic directives of the Ten Year Development Plan and the aspirations outlined by Fang Yi, Chinese demands for more sophisticated industrial imports took on great urgency, heightening their interest in concluding a long-term trade agreement with Japan.

IV. MECHANISMS FOR SINO-JAPANESE TRADE ESTABLISHED BEFORE THE LONG-TERM TRADE AGREEMENT

After normalization, the vehicle for semi-official trade was still the "Japan-China memorandum trade" (M-T trade) which had been annually renewed starting in 1968. Though theoretically distinct from "friendly trade," M-T trade had become increasingly politicized, with contracts signed under its aegis forced to explicitly accept a whole array of Chinese preconditions.\textsuperscript{57}

However, M-T trade was superseded on January 5, 1974, by the first truly bilateral governmental trade pact, the Japan-China Trade Agreement. Under the terms of this three year agreement the countries were given reciprocal most favored nation status, provision was made for payment arrangements using yen or yuan or other convertible currencies, a yearly joint government trade committee meeting was set up, and a pledge was made to promote general technical cooperation.\textsuperscript{58} By being granted most favored nation treatment the tariffs on the PRC's exports to Japan were cut in half and the duty imposed by the PRC on Japanese items slashed by one-third.\textsuperscript{59} Although it was a more promis-

\textsuperscript{56} U.S.-CHINA BUS. REV., May-June 1978, at 3-4.

\textsuperscript{57} Leng, Sino-Japanese Trade, 5 LAW & POLY INT'L BUS. 780, 787 (1973). Besides recognizing the nonseparation of political and economic matters, Japanese traders had to adopt Chou En-lai's "three political principles": (1) a friendly posture towards Peking; (2) the denial of the concept of "two Chinas"; and (3) support for the normalization of relations between China and Japan. Id. at 782-83. Japan-China Memorandum Trade trade was further burdened with four requirements laid down by Chou in April of 1970. The PRC would not trade with those Japanese companies, which "helped" Taiwan and South Korea, invested in Taiwan and South Korea, aided in the United States war effort in Indochina, or were affiliated with American interests. Id. at 794.

\textsuperscript{58} See Tsuchiya, supra note 1, at 243; Kim, Sino-Japanese Commercial Relations, in CHINA: A REASSESSMENT OF THE ECONOMY 613 (Joint Economic Committee of the United States Congress ed. 1975).

\textsuperscript{59} Tsuchiya, supra note 1, at 245.
ing device for encouraging trade expansion, the January 1974 pact had some disturbing omissions, no procedure was outlined for the entry of Japanese businessmen into China, and their legal standing while in China was left obscure. Probably most damaging was the PRC failure to protect or respect Japanese patent rights.60

Besides the main trade pact, ancillary agreements were entered into by Peking and Tokyo covering the topics of aviation (April 20, 1974), navigation (November 13, 1974) and fishing (August 15, 1975). The air transport agreement opened up routes between the PRC and Japan with JAL (Japan Airlines) obtaining landing rights at Peking and/or Shanghai, and CAAC (the Civil Aviation Administration of China) flying to Tokyo and/or Osaka; the navigation accord permitted Chinese and Japanese ships to service both countries on a regular basis.61 An interesting feature of these two agreements was the diplomatic flexibility exhibited by Peking when dealing with the nettlesome question of Taiwan. CAL (China Airlines) continued flying to Japan while using the Nationalist flag and emblem. In order to appease the PRC, Japan invented the "legal fiction" that such markings were only for private identification purposes and not a manifestation of the State of Taiwan.62 Similarly, under the provisions of the navigation agreement, Taiwan's vessels were allowed to continue to bear the Nationalist flag.63 Negotiations over fishing rights were quite protracted, as both sides became mired in extremely technical discussions involving, for example, the size of net meshes and the horsepower of boat engines. On the main bone of contention, the PRC's wish to establish a military guard line to protect its fishing fleet, the Chinese finally acquiesced.64

Both parties were required to specify the commodities to be exchanged under the conditions of the 1974 Trade Agreement. Still existing outside the ambit of this agreement was the Canton fair system deeply intertwined with the "friendly firm" trade. "Friendly firms" were those Japanese companies recommended to Peking as ideologically sympathetic to its aims, i.e., opposed to the government of Taiwan. They were given preferential consideration in trade negotiations. Using the Canton fair as their main bargaining site, these privileged institutions lasted until March of 1973, when the whole system of favoritism

60 Kim, supra note 58, at 613.
61 G. Hsiao, supra note 2, at 62.
62 Id.
63 Id. at 62-63.
was abolished. 66 While the subjective grounds on which “friendly firms” operated were eliminated, the Canton fair remained an important supplemental channel for Sino-Japanese trade. This semiannual event is held once in the Spring (April 15 to May 15) and again in the Fall (October 15 to November 15). 66 As a reciprocal gesture, the PRC has held fairs in Japan on two separate occasions since normalization; in 1974 the first fair was in Tokyo and Osaka, while in 1977 an exhibition toured Nagoya, Sapporo and KitaKyushu. 67

The amount of Sino-Japanese trade carried out through the fairs has declined in significance with the opening up of more diversified trade outlets such as direct liaisons with the PRC’s state trading corporations and contact with the many Chinese trade missions abroad. 68 Roughly one-third of China’s total export trade was handled by the fairs in 1977, but at the Spring 1978 Canton fair $280 million worth of Sino-Japanese business was conducted; a substantial drop from the estimated $350 million transacted at the previous Fall’s fair. 69 In that each Canton fair still contributes about a ten percent share of the total yearly volume in Sino-Japanese trade, 70 they do remain vital entry points, especially for smaller Japanese firms.

Given the scope and magnitude of the recently signed Long-Term Trade Agreement, a majority of the giant Japanese corporations will probably commit most of their future efforts to satisfying its goals, thus further demarcating the nature of Sino-Japanese commerce. The fairs will become increasingly the forum for those more modest-sized Japanese businesses excluded from the purview of the Long-Term Trade Agreement. From the present perspective of Chinese pragmatism, the fairs continue to be valuable instruments for scientific cooperation and exchange. Through the fairs system the Japanese have inexpensive opportunities to showcase their new products, and the PRC can painlessly keep current on all the new technological developments. 71

65 CHINA NEWSLETTER 4 (June 1978).
66 Tsuchiya, supra note 1, at 244. Other regional fairs are held on an irregular basis throughout China.
68 FAR EAST. ECON. REV., June 2, 1978, at 52.
69 Id. at 53-54.
70 Id. at 54.
71 See Heymann, Self-Reliance Revisited: China’s Technology Dilemma, 10 STAN. J. INT’L STUD. 15 (1975), where the author deals with the Chinese practice of both studying the foreign models on display, and also manufacturing their own products based on the technology copied from the foreign prototypes.
V. THE LONG-TERM TRADE AGREEMENT OF FEBRUARY 16, 1978

A. Preliminary Negotiations

In late March and early April of 1977, negotiations on the Sino-Japanese Long-Term Trade Agreement (LTTA) were initiated when a delegation representing Keidanren (the Association of Economic Organizations), regarded commonly as the most powerful business group in Japan, visited China. Even though Toshiwo Doko, the president of Keidanren, ostensibly headed the mission, the actual negotiations were conducted by Yoshihiro Inayama, who was a vice-president of Keidanren, and more importantly, the chairman of the Japan-China Association on Economy and Trade, the original proponent of a long-term agreement. It was determined that while Inayama would be the chief Japanese spokesman, Lin Hsi-wen, a vice-minister of foreign trade, would be the main negotiator for the Chinese.\textsuperscript{72} Details of the agreement were left open-ended, but the Chinese did indicate a willingness to export oil and coal and specifically mentioned a proposal made by Mr. Inayama in 1974 committing the Japanese to purchase fifty million tons of petroleum five years after the signing of a long-term agreement.\textsuperscript{73}

As momentum for the trade agreement began to build, the Japanese formed the Provisional Committee for the Japan-China Long-Term Trade Agreement, consisting of influential figures in the Japanese business community, in an attempt to expedite matters with the hope of signing an agreement by the end of 1977.\textsuperscript{74} The political clout of this lobbying organization can be easily measured. The presidents of Nippon Steel, Mitsubishi Heavy Industries and the Bank of Tokyo chaired subcommittees. In his capacity as chairman of the Promotional Committee, the ubiquitous Mr. Inayama met again with Lin Hsi-wen on September 26 and 30, 1977. The talks were most profitable. Basic understanding was then reached concerning the trade pact's overall framework.\textsuperscript{75} A Japanese draft of the agreement was hammered out at a November 22 session of the Promotional Committee in

\textsuperscript{72} \textit{China Newsletter} 17-19 (October 1977).

\textsuperscript{73} \textit{Id.} at 17. Regarding imports, the PRC suggested that the most urgent needs for equipment and plants were in the following areas: coal mining; transportation; port and harbor facilities; oil drilling; petrochemicals; and the metallurgical and power generation industries.

\textsuperscript{74} \textit{China Newsletter} 2 (January 1978).

\textsuperscript{75} \textit{Id.} at 3-4.
anticipation of the next round of negotiations, which commenced on November 25 and lasted until November 30.\textsuperscript{76}

At these November sessions, the PRC's long-range target for oil exports was set at fifteen million tons when Vice Premier Li Hsien-nien personally guaranteed that China was capable of exporting this quantity.\textsuperscript{77} The Japanese were further relieved when it was agreed that Shengli and Hua-pei brands of crude oil were to be exported along with the traditional staple of China's oil industry, Taching crude. It was speculated that these types of crudes were more suitable for Japanese markets, because they were "lighter" in composition than the "heavy," low-gravity Taching variety.

Unfortunately, in November no consensus could be reached on the amounts of ordinary coal (used mainly for electrical power generation purposes) to be exported by the PRC. The Japanese insisted on a figure of 1.1 million tons in 1982 after an initial shipment of 150,000 to 200,000 tons in the first year of the agreement, while the Chinese remained adamant about supplying 500,000 tons in 1978 and two million tons in 1982.\textsuperscript{78} Discord also marked the two sides' views on the exportation of coking coal (for iron and steel factories); the Japanese wanted to start accepting one million tons in 1982 with five million tons as a long-term goal, but the Chinese strenuously insisted on exporting coking coal from 1978 onwards.\textsuperscript{79}

**B. Terms of the LTTA**

Such negotiating obstacles may have contributed to the delays in concluding the LTTA, but February 16, 1978 was not far off the projected 1977 deadline. Technically, the agreement was signed by two consultative committees having no official mandate, but as expressed in the preamble, the pact had the full support and blessing of both governments.\textsuperscript{80}

\textsuperscript{76} Id. at 5-6. In the November meeting, Lin Hsi-wen informed the Japanese that he was now also the head of a newly created nongovernmental body, the China-Japan Long-Term Trade Council, which had been set up as a corresponding organization to the Promotional Committee.

\textsuperscript{77} Id. at 7.

\textsuperscript{78} Id.

\textsuperscript{79} Id. at 8.

\textsuperscript{80} The text of the Japan-China Long-Term Trade Agreement does not appear to have been published officially in English. The text of the agreement does appear in English in CHINA NEWSLETTER 25 (June 1978). The agreement was signed in Peking on February 16, 1978. N.Y. Times, February 17, 1978, at A10, col. 1.
Article 1 stipulated that the LTTA would run from 1978 through 1985, with each side undertaking to export ten billion dollars worth in this eight year period. For the first five years, through 1982, Japan is obligated to export about seven to eight billion dollars of technology and industrial plants plus two to three billion dollars in construction materials, machinery and equipment (article 2). In exchange, under article 2, the Chinese are to export during these years oil and coal in the following amounts:

<table>
<thead>
<tr>
<th>Year</th>
<th>Crude Oil</th>
<th>Coking Coal</th>
<th>Ordinary Coal</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>7 million tons</td>
<td>150,000 to 300,000 tons</td>
<td>150,000 to 200,000 tons</td>
</tr>
<tr>
<td>1979</td>
<td>7.6 million tons</td>
<td>500,000 tons</td>
<td>150,000 to 200,000 tons</td>
</tr>
<tr>
<td>1980</td>
<td>8 million tons</td>
<td>1,000,000 tons</td>
<td>500,000 to 600,000 tons</td>
</tr>
<tr>
<td>1981</td>
<td>9.5 million tons</td>
<td>1,500,000 tons</td>
<td>1,000,000 to 1,200,000 tons</td>
</tr>
<tr>
<td>1982</td>
<td>15 million tons</td>
<td>2,000,000 tons</td>
<td>1,500,000 to 1,700,000 tons</td>
</tr>
</tbody>
</table>

The quotas for coal indicate how each side had compromised in order to overcome the stumbling blocks encountered during the November 1977 negotiations. For ordinary coal, the 1978 figure essentially matches Japanese expectations, but the 1982 amount is much closer to the Chinese goal of two million tons. As for coking coal, Tokyo made the major concession—accepting this form of energy immediately and also taking on double the quantity that had originally been planned for 1982. On the issue of coking coal, Japanese complaisance is particularly pronounced, because its capacity to absorb metallurgical coal was limited by contractual commitments to other foreign suppliers.81

According to article 2, the amounts of commodities to be exported from 1983 through 1985 were to be determined in 1981. During these last three years, China was additionally assured that its exportation of oil and coal would only increase in quantity, with 1982 to be used as the base year in calculations.

In very opaque terms article 3 of the LTTA called for Peking's imports to be paid on a “deferred payment formula.” Specific financial terms, including appropriate interest rates, were to be negotiated later, since the two parties had been unable to settle their differences.82

While not theoretically a “product payback” scheme, the intrinsic structure of the LTTA is very close in spirit to Teng's concept—

81 China Newsletter 8 (January 1978).
82 Id. at 2 (June 1978).
China's natural resources are to be bartered away for much needed infusions of high technology. Unlike "product payback," nothing in the LTTA requires that each import of Japanese industrial goods be financed by a corresponding quantity of oil or coal; on the other hand, the LTTA does not foreclose future application of this financing method.

Under article 4, transactions under the LTTA were to be "conducted on the basis of reasonable international prices and international trade practices." Those onerous political conditions, formerly prerequisites for trade under the terms of M-T and "friendly firm" contracts, have now been superseded by the objective standards of international commerce—further evidence of the Chinese eagerness to rationalize its economic practices and extirpate ideological factors from its development program.

In article 5, both sides were to extend technical cooperation and provide for expanded economic exchange. Under article 8, each signatory was to create a secretariat which would be entrusted with the agreement's implementation; moreover, designated representatives were to meet annually to iron out any difficulties. If a problem became insurmountable, arbitration would be instituted according to the procedures set forth in the Japan-China Trade Agreement of 1974. Finally, article 10 stated that "[c]ontracts concluded based on this Agreement shall not be annulled unless by mutual consent of both parties concerned." Once again the Chinese have adopted a principle central to the proper enforcement of commercial law—the constraining effect of contractual obligations prohibiting the unilateral repudiation of such duties.

Conforming with established practice, LTTA contracts were to be signed by individual Chinese trading corporations which possess their own "legal personality." A state trading enterprise can be liable to the extent of its assets, but its actions cannot bind other trading companies or the Chinese government per se: "Although the corporations are owned by the state the acts of the corporations are not acts of the state." While the state cannot be held directly responsible for a trading company defaulting on its obligations, the government will ensure that such an entity will not escape its commitments by being either undercapitalized or going into bankruptcy.

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83 Id.
85 Id.
In a revealing and informative interview in November of 1977, Jen Chien-hsin, the director of the Legal Affairs Department of the China Council for the Promotion of Foreign Trade, summarized the PRC's current attitudes toward foreign trade. A policy of "independence and initiative" and "equality and mutual benefit" was to be followed, including consideration of customary standards in the area of foreign trade law. This respect for the reasonable norms of international commerce was provided for in article 4 of the LTTA. Possibly, this new Chinese approach will help cure some of the procedural hardships previously encountered in trading with Peking. When China purchased goods in the past, the foreign seller was commonly forced to produce an exhaustive and detailed package of shipping documents, but if China was the seller, these requirements were either omitted or couched in very vague general terms. Compiling these shipping documents was a particularly laborious and difficult task, because Chinese inspectors were fastidious and uncompromising in rejecting goods for the slightest degree of nonconformity.

Another glaring inequity was the lack of remedy for a breach of contract by the Chinese party, while, on the other hand, the foreign signatory was usually covered by a breach of contract clause. Specific performance was strongly preferred by the Chinese over money damages as the remedy for a breach of contract because there often exists a crucial relationship between a particular foreign trade contract and the implementation of a carefully thought out domestic economic project. Since the fulfillment of economic plans is a matter of primary importance to the Chinese government, money damages are often a poor substitute for the performance of a contract.

Even though arbitration is possible under the LTTA, the Chinese have shown great aversion towards its application. Informal mediation and negotiation has always been favored over the more formal, litigious nature of an arbitration proceeding. Contributing to this dislike of arbitration has been the Chinese inclination towards the remedy of specific performance. In an arbitration hearing, this alternative is normally foreclosed, since the respective positions of the two parties tend to be frozen. Like the rest of China's trading partners

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86 Id. at 162.
88 Id. at 652.
89 Id. at 653.
the Japanese have not taken advantage of its prerogatives in the arbitration area, and has instead chosen to absorb the losses without putting in any claims.\textsuperscript{90} Under the LTTA, if arbitration is to be carried out, the Chinese Foreign Trade Arbitration Committee (FTAC) must be utilized. Usually each side in the dispute picks an arbitrator from the FTAC's list of twenty-one members, and in turn, these two will select a third person to act as a referee.\textsuperscript{91} Jen Chien-hsin has stated that the arbitrators, in their choice of law decision, are free to apply China's, the foreign party's home country's, or even a third nation's substantive law.\textsuperscript{92}

C. The September Extension to the LTTA

Succumbing to the euphoria over the initial success of the LTTA, negotiations to extend the pact were concluded on September 14, 1978 in Peking, by Toshio Komoto, the Japanese Minister of International Trade and Industry, and Vice Premier Li Hsien-nien on behalf of the PRC. In the first six months of 1978, Japanese firms had contracted for almost ten billion dollars worth of exports with the PRC, which was equivalent to the total amount of Japanese exports contemplated for the life of the February agreement.\textsuperscript{93} In addition, more optimism about the future of Sino-Japanese trade was generated by the signing in August 1978 of the Sino-Japanese Peace and Friendship Treaty.

In the September 14th modification of the original LTTA, the following were the salient points of agreement: (1) the duration of the LTTA was extended five more years from 1985 to 1990 with an estimated $80 to $100 billion in trade planned for 1978 to 1990, compared to the original projection of twenty billion dollars for the 1978 to 1985 period; (2) a regular ministerial-level conference was established to discuss trade matters; (3) Japan will cooperate with China to help develop the latter's electrical power potential, its coal mines and its nonferrous metal industries; (4) a treaty on science and technological exchange will be entered into by the two nations; (5) Japanese businesses will be permitted to open offices in China in order to facilitate their trading activities; and (6) the PRC tentatively ac-

\textsuperscript{90} Henderson & Matsuo, \textit{Trade with Japan}, in \textit{Law and Politics in China's Foreign Trade} 54 (V. Li ed. 1977).
\textsuperscript{91} Shaney, \textit{supra} note 87, at 654.
\textsuperscript{92} Heuser, \textit{supra} note 84, at 165.
accepted the Japanese request that interest rates for the financing of its import program be calculated according to OECD guidelines.94

The September amendments to the LTTA moved away from quantifying the course of the bilateral trade to concentrating more on long-range development assistance, with the Japanese acting as consultants and advisers. Some of the points initially raised in February also were clarified further. Instead of a general statement of intent supporting technological interchange, the two countries were ready, in September, to sign a formal treaty on technology transfer. Furthermore, the application of the OECD's criteria on interest rates replaced the ambiguities in article 3 of the February accord.

D. Political Implications of the LTTA

While the present Chinese enthusiasm for stimulating trade with Japan is transparent and unabated, the PRC has not been completely oblivious to the benefits of putting political pressure on Japan. As a bargaining tool, the Chinese always can play on Japanese anxiety and suspicions about Russian motives and aspirations in Asia. Tokyo's traditional mistrust of the Soviet Union has been accentuated in 1978 by the latter's intransigence over the "Northern Islands" problem. Irredentist emotions in Japan run very high over these four islands in the Kurils (a chain of islands extending between Hokkaido in Japan and the Kamchatka peninsula in Siberia), which the Japanese claim have been illegally occupied by the Soviet Union since the end of World War II. On the other hand, one must not forget the extent of Japanese financial participation in several massive Siberian projects, such as the construction of the Vrangel port facilities, the exploration for coal and natural gas in the Yakutsk region, and the exploitation of the abundant timber resources.95

Chinese political coercion was effectively at work in connection with the abortive attempt by the Soviets to secure Japanese cooperation and investment for the development of the Tyumen oil fields in Western Siberia. Initially, the Russians offered forty million tons of oil annually to the Japanese (later reduced to twenty-five million tons a

94 For a general review of the terms of the September extension, see id. at 1-2. Also see U.S.-CHINA BUS. REV., September-October 1978, at 70. Further discussion of the OECD (Organization for Economic Cooperation and Development—an international group consisting of 24 of the world's industrial nations including Japan) and its guidelines will be found at pp. 328-31 infra.

95 FAR EAST. ECON. REV., August 18, 1978, at 45-46.
year) in exchange for financial assistance estimated in the billions of dollars. In comparison, the Chinese proposals on oil exports would not entail such substantial Japanese financial exposure, although the fifteen million ton figure set in the LTTA for 1982 was far short of twenty-five million tons. When the Soviets decided to build a second Siberian railroad for transporting Tyumen oil to their Pacific northeast region, vigorous Chinese protests over Japanese involvement was a persuasive factor in leading the Japanese to opt out of the Tyumen project. According to Peking, this new rail line could only improve Moscow's military transport capabilities to reinforce its troops facing China along the two nations' common border.

Political leverage also entered into Japanese calculations concerning the value of entering into LTTA. A major economic alliance with their largest Asian neighbor would act as a countervailing force against the uncertainty and recent tensions in Japanese relations with the United States and Western Europe. Growing resentment over Japanese economic penetration had precipitated a new wave of protectionism. For many Japanese businessmen, the panacea for their mounting economic woes was naturally a large volume of trade with the Mainland. Clearly Keidanren, as the principal voice for the large Japanese trading concerns, was instrumental in getting the LTTA signed. Its powers of persuasion were especially impressive considering that the Japanese petroleum and electrical power industries were very nervous about the quality and quantity of the PRC's oil products. In contrast to this apprehensive attitude for the "leaders of the largest Japanese manufacturing firms, however, the combination of what they believed to be a vast and dependable export market and a source of energy supply potential as vast—if somewhat less dependable—was irresistible."97

VI. SINO-JAPANESE PEACE AND FRIENDSHIP TREATY

A. Tentative Steps

With the establishment of close commercial relations, the next logical move was the drafting of a Sino-Japanese Peace and Friendship Treaty (Friendship Treaty) to cement political ties. One of the rationales suggested for Chinese interest in such a bond was the Maoist

96 Id. at 46. Also see Clough, The International Impact of China's Foreign Trade, in POST-MAO CHINA AND U.S.-CHINA TRADE 147-48 (S. Leng ed. 1977).
97 Fukui, Japan and China: Peace at Last, 75 CURRENT HIST. 149, 152 (1978).
doctrine of the “Three Worlds.” Making up the “first world” were the “imperialist” United States and the “social imperialist” Soviet Union, both of whom were the “common enemies of the people of the world.” In the “second world” were Europe, Canada and Japan—the rest of the industrialized nations—while China was a proud member of the “third world,” consisting of the developing nations in Africa, Asia and Latin America. For the third world countries, the primary aim was to struggle against the tyranny and oppression represented by the first world. But since the second world also is subjugated to the first world, “in its struggle against hegemonism, the third world should wherever possible win second world countries to the common revolutionary cause.”

“Hegemonism” has become synonymous with Russian aggression, in the Chinese view, ever since the 1968 Soviet invasion of Czechoslovakia. Menaced by the Russian bear in the north and its client-states like Vietnam in the south, the PRC’s obsessive preoccupation with hegemony is somewhat understandable, especially in light of its rather parlous state of military preparedness. When Vice Minister for Foreign Affairs Han Nien-lung visited Tokyo in November 1974, he stressed the need for an anti-hegemony clause in a Friendship Treaty. The Tanaka-Chou Communiqué on normalization contained such language; thus, so should the treaty, as a natural outgrowth of the communiqué. To the Chinese, the ratification of a Friendship Treaty would be a symbolic culmination of events following normalization, and also would signal the cessation of the technical state of war which had existed since the inception of the Sino-Japanese conflict in 1937.

Japanese response to the PRC’s overtures was one of hesitation, attributable to both domestic opposition within the ruling Liberal Democratic Party (LDP) and harsh warnings by the Soviet press over the dire consequences of such an agreement.

Adding to the internal political disarray was the forced resignation of Kakei Tanaka in the aftermath of the Lockheed scandal, and his replacement by Takeo Miki, who had to act gingerly in the foreign policy area while trying to consolidate his domestic position. By May of 1975, however, Miki had indicated to Peking his willingness to proceed with treaty negotiations. In late September of that same year, foreign
minister Kiichi Miyazawa conferred with the PRC's foreign minister, Chiao Kuan-hua in New York City, while both men were attending the United Nations General Assembly session. Relations soured when Miyazawa presented the Chinese minister with his four points or conditions regarding the inclusion of an anti-hegemony provision in the treaty. Under Miyazawa's view, the clause would only be palatable if it were made clear that the language was not specifically directed against a third country, i.e., the Soviet Union, if it would not necessitate joint Sino-Japanese action, if it would be applicable beyond the Asian region, and if it was in conformity with the spirit of the United Nations Charter. Of course, the PRC reaction to Miyazawa's qualifications was predictably negative, and talks were suspended.

Shortly after Takeo Fukuda took office in early 1977 he tried to end the stalemate by asking Yoshikatsu Takeiri, the chairman of the Komei Party, to convey a message to Hua Kuo-feng expressing his desire to reactivate treaty negotiations. Moreover, Fukuda's cabinet secretary and later foreign minister, Sunao Sonoda, observed that the new government did not feel morally bound by Miyazawa's four points. Fukuda spent the rest of 1977 endeavoring to piece together a coalition within the dissension-torn ranks of the LDP in support of the rapprochement with China. Of particular concern to him were those unruly factions within the LDP strongly loyal to Taiwan.

By the beginning of 1978, Fukuda's determination to conclude a treaty had taken on a new urgency because of two factors. First of all, the Japanese decided to separate developments in Sino-Japanese relations from the unsatisfactory progress being made in normalizing ties between Moscow and Tokyo. Moscow's suggested draft of a Good Neighborhood and Cooperation Pact with Japan had stunned an incredulous Tokyo by demanding the virtual renunciations of the United States-Japan security arrangement and the shelving of the Kuril Islands question. Secondly, Fukuda was under severe domestic pressure to do something dramatic and flamboyant to revive his sagging popularity, which had been affected by the opening of Narita airport and a worsening business slump. Encouragement also was emanating from Peking: Zbigniew Brzezinski, in briefing Fukuda on his talks with the PRC in May of 1978 indicated that Peking wanted a resumption of

102 Id. at 119.
104 Id. at 8.
treaty negotiations. It was also Brzezinski's impression that the dispute over the Tiao Yu-t'ai Islands (referred to by the Japanese as the Senkaku Islands) would not be an obstacle to the successful conclusion of a Friendship Treaty.\textsuperscript{106}

B. \textit{The Tiao Yu-t'ai (Senkaku) Islands Controversy: Legal and Political Ramifications}

1. Impact on Sino-Japanese Relations in 1978

The dormant contest over control of the Tiao Yu-t'ai (Senkaku) Islands\textsuperscript{107} had suddenly erupted again on April 12, 1978. A fleet of 137 Chinese fishing boats intruded into what was considered by Tokyo as Japanese territorial waters around the Senkaku Islands. A series of such trespassing incidents continued for several days before the Chinese voluntarily withdrew. Within the LDP, the anti-treaty groups unleashed a storm of protest. Over thirty of these conservative LDP members were visiting Taiwan around the times of the Senkaku imbroglio.\textsuperscript{108}

The Chinese leadership initially appeared as befuddled and nonplussed by the Tiao Yu-t'ai incursions as the Japanese. However, through Vice Premier Keng Piao, the PRC quickly assured Tokyo that the incidents were "accidental" and "unplanned," resulting from overzealous fishermen in "hot pursuit" of fish.\textsuperscript{109} Some China watchers speculated that the crisis was deliberately fomented by local elements in the PRC's eastern maritime provinces still faithful to the Gang of Four.\textsuperscript{110} More plausibly, Peking may have felt that this show of strength, combined with a willingness to put aside the Tiao Yu-t'ai territorial question, would be favorably compared by the Japanese to Russian obstinancy over the Kuril Islands issue.

From the Japanese point of view, Tokyo and Peking were said to have reached a "tacit understanding" at the time of normalization that "neither country will touch on" the problem of the Senkaku Islands.\textsuperscript{111} Semantically this phrase had a different political shading from "shelving" the issue. "Shelving" the dispute recognized its negative effect on

\textsuperscript{106} N.Y. Times, May 24, 1978, at 24, col. 3.
\textsuperscript{107} These islands are eight small islets and rocks 120 nautical miles northeast of Taiwan and approximately 200 nautical miles west of Okinawa, the most well-known island in the Ryukyus.
\textsuperscript{108} FAR EAST. ECON. REV., May 12, 1978, at 25.
\textsuperscript{109} \textit{Id.}, April 28, 1978, at 10.
\textsuperscript{110} \textit{Id.} at 12.
\textsuperscript{111} Asahi Shimbun, April 16, 1978, at 2.
the whole process of normalization, while "neither country will touch on" implied that both sides had for the indeterminate future agreed to ignore the question entirely without acknowledging it as an impediment to normalization. Chinese consent to this approach of not "touching on" Tiao Yu-t'ai was illustrated when Teng Hsiao-ping signed the Friendship Treaty in Japan. He reiterated that the question of the Senkaku Islands should be left to the next generation to work out.

Besides brushing aside the Tiao Yu-t'ai controversy, the PRC also chose not to use the approval by the Japanese Diet in June 1977 of the Japan-South Korea Agreement on the joint development of the continental shelf in the East China Sea as an excuse to jeopardize negotiations on a Friendship Treaty. To be sure, Peking reacted verbally to the Diet's ratification move, with the Foreign Ministry protesting vehemently.

The East China Sea continental shelf is the natural extension of the Chinese continental territory. The People's Republic of China has inviolable sovereignty over the East China Sea continental shelf. It stands to reason that the question of how to divide those parts of the East China Sea continental shelf which involve other countries should be decided by China and the countries concerned through consultations. The so-called Japan-South Korea agreement on joint development of the continental shelf... is entirely illegal and null and void...

Chinese flexibility on these two interrelated issues of the Tiao Yu-t'ai Islands and the exploration of the East China Sea continental shelf was particularly revealing, considering the importance of these questions from both an international law and an economic standpoint. Under the terms of the LTTA, perhaps the pivotal factor in the PRC's ability to pay for its ambitious importation program is optimism concerning future petroleum production. Favorable estimates about China's oil potential partially rely on the undiscovered riches in the East China Sea region stretching from southern Kyushu in Japan to the Tiao Yu-t'ai Islands just above Taiwan. The Japan-South Korea
Agreement on joint continental shelf development was designed to resolve conflicting claims over two clusters of obscure islands, respectively named the Danjo Gunto and Tori Shima group. Many of the legal arguments advanced by China against Japan and by Korea against Japan are quite similar because the Danjo Gunto and Tori Shima Islands and the Tiao Yu-t'ai Islands share the same topographical features. Bordering these islands on their eastern sides is the Okinawa Trough, a great cavity in the ocean floor which plays a vital role in calculations on ownership of the continental shelf. In both instances, there are two interlocking issues; territorial sovereignty over the islands themselves and the legal effect given the islands in the demarcation of the continental shelf.\textsuperscript{116}

2. The Continental Shelf Problem

Complicating the Tiao Yu-t'ai situation are the claims of Taiwan which were asserted on July 17, 1969, through a declaration of sovereignty over all natural resources in the continental shelf adjoining Taiwan's territorial waters. In 1970, Taiwan also signed exploratory contracts with four foreign oil companies, including Gulf and Amoco, for the development of offshore oil deposits.\textsuperscript{117} These moves on the part of Taiwan were in answer to the actions taken by the Ryukyu (Okinawa) government in 1969. At the time, the Ryukyu Islands were still administered by the United States as a post-World War II legacy. In early 1969, competing applications supported by Japanese interests were made on behalf of citizens of Okinawa for mining rights in the East China Sea around Tiao Yu-t'ai.\textsuperscript{118} When the Ryukyu government proposed to form its own oil company on December 4, 1970, the PRC intervened in the controversy and staked its claim to both the East China and Yellow Sea continental shelves.\textsuperscript{119} In addition to offsetting concluded that there was the “high probability . . . that the continental shelf between Taiwan and Japan may be one of the most prolific oil reservoirs in the world.” \textit{Quoted in Park, Oil Under Troubled Waters: The Northeast Asia Sea-Bed Controversy}, in \textit{STUDIES IN EAST ASIAN LAW} 213 (Harvard Law School, 1973).

A Norwegian oceanographer, Jan-Olaf Willums, has put the potential reserves of the East China Sea basin between 8 and 10.5 billion tons (60 to 80 billion barrels). \textit{Cited in S. HARRISON, CHINA, OIL AND ASIA: CONFLICT AHEAD?} 43, 55, 275, 278 (1977).

\textsuperscript{116} Park, \textit{supra} note 115, at 248.
\textsuperscript{117} \textit{Id.} at 224.
\textsuperscript{118} \textit{Id.} at 221-22.
\textsuperscript{119} \textit{Id.} at 222, 230.
the intrigues of the Ryukyu government, the PRC's announcement was aimed at squashing any discussion of joint continental shelf development among Japan, Taiwan and South Korea. Not wanting to offend the PRC, both the United States and Japan decided to freeze development projects in the Tiao Yu-t'ai area until final disposition of the legal issues involved.120

The 1958 Geneva Convention on the Continental Shelf is the chief fount of the legal principles applicable to the Senkaku dispute. "Continental shelf" is defined in article 1 of the Geneva Convention as the seabed and subsoil of "submarine areas adjacent to the coast [of a continent or of islands] but outside the area of the territorial sea, to a depth of 200 meters, or beyond that limit, to where the depth of the superadjacent waters admits of the exploitation of the natural resources of the said areas." According to article 2(1) the "coastal state" has "over the continental shelf sovereign rights for the purpose of exploring it and exploiting its natural resources." When there are conflicting claims by "coastal states," reference is made to article 6(1).

[T]he boundary of the continental shelf appertaining to such States shall be determined by agreement between them. In the absence of agreement, and unless another boundary line is justified by special circumstances, the boundary is the median line, every point of which is equidistant from the nearest point of the baselines from which the breadth of the territorial sea of each state is measured.121

Under article 6(1), deviation from the generally used median line criterion is justified by "special circumstances." Amplification of this doctrine was provided by the International Court of Justice in its famous 1969 decision, the North Sea Continental Shelf Cases.122 While observing that the division of the continental shelf should be regulated by "equitable principles," the International Court of Justice also agreed that delimitation should leave to "each Party all those parts of the continental shelf that constitute a natural prolongation of its land territory into and under the sea, without encroachment on the natural prolongation of the land territory of the other."123

Chinese pronouncements on the East China Sea continental shelf issue must be viewed in connection with their consistent support for

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120 Id. at 233.
121 Quoted in id. at 235.
122 Id. at 235-36.
Third World proposals to expand the jurisdiction of coastal nations over territorial waters.\(^\text{124}\) Pointing to the precedent established by *North Sea Continental Shelf Cases*, the PRC has maintained that the East China Sea continental shelf is a "natural prolongation" of Chinese territory, enabling Peking to gain control over almost 600 miles of shelf in the northern parts of the East China Sea and around 200 miles in the southern end near Taiwan and Tiao Yu-t'ai.\(^\text{125}\) The PRC regards the Okinawa Trough as the logical termination line to the East China Sea continental shelf; it thus serves as the boundary to Peking's "natural prolongation" claims. The location of the Trough, argue the Chinese, constitutes the "special circumstances" anticipated by the *North Sea Continental Shelf* decision. On the other hand, the Trough has no legal or geographical relevance for the Japanese, who adhere to the more restrictive median line technique. Under the median line principle, the Trough is simply disregarded. Instead, the Tiao Yu't'ai Islands are used as the base points, and in drawing a line equidistant from these islands, Japanese sovereignty would extend over a large tract of continental shelf.\(^\text{126}\) Parallel theories have been advanced by the South Koreans and the Japanese over the role of the Danjo Gunto and Tori Shima Islands in delimiting the continental shelf.

3. Territorial Claims

International recognition of Japanese ownership of the Senkaku Islands would help justify the application of the median line doctrine. However, if the islands are awarded to the PRC, the status of the Okinawa Trough as the natural dividing line in the East China Sea would be reinforced.

Four different concepts have been offered by the Chinese on behalf of their territorial claims. Geographical contiguity is a corollary of the "natural prolongation" argument. In support, it is contended that because the continental shelf is part of the Chinese mainland, so are the islands situated on the eastern end of the shelf. Next, the PRC refers to the dictates of custom and usage—the areas around Tiao Yu-t'ai have been traditional fishing grounds for Chinese fishermen. Third, the islands were first discovered by the Chinese in 1403. Final-

\(^\text{124}\) *Peking Rev.*, August 16, 1974, at 5-6.
\(^\text{125}\) For a recent restatement of this position, see *Peking Rev.*, June 30, 1978, at 25.
\(^\text{126}\) Park, *supra* note 115, at 242-43.
ly, the disposition of the Tiao Yu-t'ai Islands under treaties is adduced by Peking in support of its claim to title. Upon China's defeat in the Sino-Japanese War of 1895, Taiwan and its adjoining islands (including Tiao Yu-t'ai) were ceded to Japan under the Treaty of Shimonoseki. In 1945, Tokyo agreed, under the conditions of the Cairo Declaration, to return all territory stolen from China. This settlement also encompassed the spoils of 1895.127

By itself contiguity has never been sufficient in the past to settle territorial disputes.128 Allegiance to customary usage arguments could backfire on the PRC, since the April 1978 incidents demonstrated that the Japanese have temporarily seized de facto control of the fishing waters around the Senkaku Islands. As for the idea of possession through discovery, Tokyo might be able to prove that true ownership to the islands was not established by the Chinese "sightings" in the Fifteenth Century, but rather by the formal steps taken in Japan in 1895. It is unclear whether Chinese actions before 1895 were tantamount to occupation and control,129 although there is an Imperial Edict of 1893 which purports to convey part of the islands to a private Chinese citizen.130

Following the end of World War II, the Senkaku Islands were included in the Ryukyu Islands under United States trusteeship. On December 27, 1953, a local ordinance formally placed the islands within the purview of the Ryukyu government's administrative powers, without the Chinese raising any objections.131 Nevertheless, the Japanese proprietary rights to the Senkaku Islands on this basis can be rebutted by the PRC, since silence cannot be equated with consent in matters of territorial sovereignty.132 Another flawed argument put forth by the Japanese is dependent on the terms of the United States-Japan Reversion Treaty of May 15, 1972, permitting Tokyo to exercise complete dominion over the Ryukyus (including the Senkaku Islands). Conveniently ignored is the United States admonition that the Reversion Treaty did not settle any underlying dispute over possession of

127 See id. at 248-54, for a general history of the Tiao Yu-t’ai Islands and China’s four arguments in support of its sovereignty over the islands.
129 Li, China and Off-Shore Oil: The Tiao-yu-Tai Dispute, 10 STAN. J. INTL STUD. 143, 153 (1975).
130 Park, supra note 115, at 130.
131 Li, supra note 129, at 152.
132 The Island of Palmas Case, note 128 supra.
Tiao Yu-t'ai, but was intended to act solely as an administrative expedience.\footnote{188}

4. Resolution of the Tiao Yu-t'ai Question

After analyzing the various Japanese and Chinese positions on Tiao Yu-t'ai, one is led to conclude that there is no legal theory which unequivocally tips the balance one way or the other. Furthermore, although both the PRC and Japan have invoked the law of the sea principle laid down by the 1958 Geneva Convention on the Continental Shelf, their reliance does not have any binding legal impact, since neither is a signatory of the Convention. There is no assurance that either nation will continue to respect the prescriptions of the 1958 Convention, especially if the impasse over the Senkaku Islands is not ended soon. After all, most of the tenets of international law were the creation of Sixteenth and Seventeenth Century European powers.\footnote{184} In the eyes of the Chinese, their professed solidarity with the developing world usually requires them to reject traditional principles of the law of the sea as the products of imperialist and colonial maritime powers. “[T]he hegemony of superpowers trying to partition and control the seas must be firmly opposed.”\footnote{185} If the PRC regards Japan as a fellow sufferer under the yoke of an international law system devised by an ethnocentric Europe, its attitude toward the Tiao Yu-t'ai issue might be more conciliatory. Peking might suggest that both sides should calmly and independently arrive at their own solution free of the restrictions imposed by an antiquated and unjust version of international law. But if Japan is viewed as a new superpower seeking economic self-aggrandizement at the expense of the PRC, Peking could prove to be an intractable adversary.

Since the legal arguments are inconclusive, a peaceful resolution of the Tiao Yu-t'ai problem will entail full and measured consideration of the political and economic motivations at work. Tiao Yu-t'ai could pose great dangers for long-range Sino-Japanese trade prospects. A possible scenario would envision persistent Japanese assertions of sovereignty over the islands, frustrating PRC efforts to exploit the offshore oil deposits. In turn, this would engender great hostility in Peking and threaten the smooth functioning of the LTTA, because the

\footnote{188} Park, \textit{supra} note 115, at 255.  
\footnote{184} Li, \textit{supra} note 129, at 154-55.  
\footnote{185} Id. at 155.
PRC's reliance on oil as its main source of financing in the burgeoning trade with Japan would be severely undermined. Pragmatists within the Japanese leadership should point out that the Senkaku controversy has Tokyo working at cross-purposes with its own self-interest. Let the PRC develop the petroleum resources of the East China Sea in order to better meet the costs of modernization as represented by the LTTA. A compromise solution might include Japanese technical and financial assistance under the guise of a joint venture project or a product payback arrangement. What makes the Tiao Yu-t'ai conundrum so vexing is the presence of a third interested party, Taiwan. How the future of PRC-Taiwan relations will be influenced by the dispute over Tiao Yu-t'ai can only be a matter of conjecture.

C. **Provisions of the Sino-Japanese Friendship Treaty**

With the agreed upon non-discussion of the Senkaku Islands problem, the dominant remaining obstacle to the signing of a Friendship Treaty was the inclusion of an anti-hegemony clause. Unable to sway the Chinese from their inflexible stand on hegemony, Japanese negotiators sought at least to dilute the clause's impact. Yosuke Nakae, the head of the Asian Affairs Bureau of the Foreign Ministry, made the anti-hegemony principles analogous to non-interference in domestic affairs. Moreover, the Japanese did induce Peking to change the phrase from "each country will oppose" efforts at establishing hegemony to "each is opposed," in order to discourage any hint of the possibility of joint military action being taken against hegemonism. As a final concession to Japanese apprehension over irritating Moscow, article IV was introduced, stating that the treaty "shall not effect the position of either Contracting Party regarding its relations with third countries." This language was not as precise as the original Japanese proposal, which assured that "[t]he treaty is not directed against any specific third country," but was sufficient to mollify Tokyo.

On August 12, 1978, the historic Treaty of Peace and Friendship was signed in Peking by Huang Hua and Sunao Sonoda, the foreign ministers, respectively, of the PRC and Japan. The treaty was to run for a ten year period and then continue indefinitely until terminated upon one year's written notice by one of the signatories. In article 1(1),

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187 *Id.* at 20.
the two sides essentially embraced the PRC's "Five Principles of Peaceful Coexistence" as the ideological underpinning for their friendship: "Durable relations of peace and friendship between the two countries on the basis of the principles of mutual respect for sovereignty and territorial integrity, mutual non-aggression, non-interference in each other's internal affairs, equality and mutual benefit and peaceful coexistence."  

Article II was the controversial anti-hegemony clause prohibiting each nation from seeking hegemony in the "Asia-Pacific region or in any other region," and opposing efforts by other countries to impose hegemony. Economic ties, according to article III, were to be developed in conformity with the "principles of equality and mutual benefit."

Viewing the treaty as a whole, the PRC did manage to incorporate the concept of hegemony but gradually acceded to Japanese demands for modification, so that the end result was not far from satisfying Miyazawa's original four points. For Peking, the critical element was the legitimization of its anti-hegemony posture for as Teng Hsiao-ping observed, it "is the first time that such a stipulation is included in an international treaty." Besides being directed against the truculency of the Soviet Union, article II also restrained Japan and China. Chinese comments on the Friendship Treaty admitted that China's potential for aggression, with its abundant natural human resources, caused other nations to worry about China's future tendencies toward hegemonism. Disavowing hegemony was even more necessary for Japan since "many Asian countries which suffered from Japanese militarism's aggression fear and oppose Japan's embarking again on the militarist road."

Chinese fears about the dominating nature of Japanese economic activity were also implicitly expressed in the hegemony language. Japan's recent military escapades were firmly in the mind of Fukuda, who saw the treaty as a pledge that the miseries afflicting Sino-Japanese relations in the Twentieth Century would not occur again. For Tokyo, the Friendship Treaty was partial atonement for the abuses of World War II.

142 Id., October 20, 1978, at 20.
143 Id., October 27, 1978, at 4-5.
Article III and its "principles of equality and mutual benefit" could lead to "all possible forms of cooperation, including loans, in agricultural and industrial production or developmental projects." One wonders if the "principles of equality and mutual benefit" can be generously interpreted to encourage the formation of joint ventures in developing the PRC's natural resources or its archaic industrial base.

D. Varying Interpretations of the Friendship Treaty

Immediate reaction to the treaty in official Japanese circles was over what were considered major PRC concessions, pointing to the newly worded hegemony clause, the non-recurrence of Senkaku Islands incidents, and a vague promise by Peking to abrogate the Sino-Soviet Treaty. One newspaper editorial cautioned that the Soviet Union would regard the Friendship Treaty as the final link in Japan-United States-China axis, making it incumbent on Tokyo to stress how objective its "omnidirectional peace diplomacy" actually was. Other Japanese politicians averred that an "omnidirectional" foreign policy meant Japan could still give priority to relations with Peking over those with Moscow as long as Tokyo was not actively antagonistic to the Russians. A distinction was drawn between the non-resolution of the Senkaku Islands dilemma and the Kuril Islands problem. The former were still uninhabited while the Soviet Union had occupied the Kurils for over thirty years. Fueling the implicit anti-Russian gloss put on the treaty was the deep-seated Japanese antipathy toward the Russians, who were consistently ranked as the "most disliked" foreigners in public opinion polls.

Soviet anger over the treaty was concentrated more on the PRC rather than on Japan. Tass caustically remarked that "the treaty is in conflict with the interests of peace and detente, it is fraught with tremendous dangers primarily to the people of Southeast Asia, who have already long been target of aggressive aspirations of Peking leaders."

While the majority of the Japanese leadership remained uncomfortable about the unstated anti-Soviet bias of the Friendship Treaty, the

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144 Id., October 20, 1978, at 122.
147 Id., August 18, 1978, at 5.
148 Id.
PRC was understandably elated. For instance, Teng suggested efforts should be made in Japan to strengthen its defensive capabilities, and thereby contribute to the overall movement to stop the spread of Russian militarism. To demonstrate the PRC's magnanimity, Teng also agreed to cancel the moribund Sino-Soviet treaty of friendship and alliance, with its explicit anti-Japanese tone, through the New China News Agency. Japanese mortification and discomfiture over the PRC's heavy-handed interpretation of the Friendship Treaty was greatly increased when General Chang Tsai-chien, deputy chief of the General Staff of the People's Liberation Army, visited Japan soon after the signing of the pact. He brought up the subject of military cooperation between the two countries, and courted the more hawkish generals in the Japanese Self-Defense Forces. General Chang's blatant attempts to rouse the Japanese high command against the Soviet Union even compelled such an ardent militarist as Yasahiro Nakasone of the ruling LDP to advocate concluding a treaty with Moscow to balance out Japan's foreign policy offensive.

The signing of the Friendship Treaty does initially appear to be a diplomatic triumph for the PRC. At the minimal sacrifice of making some "face-saving" compromises to placate Tokyo, Peking achieved its primary goal of acquiring a new weapon for its arsenal against the "cancerous" growth of Russian imperialism. For Tokyo, the treaty was another confidence-building move designed to ensure the continued flourishing of Sino-Japanese trade. But this intangible benefit was accomplished at a substantial cost—the Soviet Union's paranoia about an Asian conspiracy directed against Moscow was intensified, and as a result the establishment of better relations between Moscow and Tokyo will be an arduous and excruciating task.

VII. CHINESE EXPORT ITEMS UNDER THE LTTA

A. Prospects for the PRC's Petroleum Industry

The exportation of oil has been assigned a central place in China's modernization movement. Instead of being a commodity regarded by the Gang of Four as too rare to sacrifice in foreign trade, oil was to be exported as "the crowning achievement of self-reliance" which played a

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152 Id.
154 Id.
major role in the country's "trade for commodities necessary for the
collection of socialism." Such a constructive use of oil resources
was vigorously highlighted at the "First National Learn from Taching
in Industry Conference," held in April and May of 1977. At this
gathering, Yu Chiu-li, chairman of the State Planning Commission,
exhorted the masses to develop ten more oil fields as large as Taching
before the end of the century. As the paragon of industrial productivi-
ty in China, Taching alone accounted for about forty-five percent of
the PRC's total petroleum output in 1976.

One of the chief difficulties in accurately determining the PRC's oil
export capacities is the evasiveness and lack of precision in Chinese
data on their oil reserves. No official information has been released
since the Cultural Revolution. When in 1973 Peking proudly pro-
claimed that its reserves were ranked third in the world, no statistical
evidence was introduced. More recently a projected goal has been
set calling for a 1990 annual production of 400 million tons or three
billion barrels (the conversion rate is one ton to about 7.5 barrels),
which is approximately the current level of Saudi Arabia's output.
Oil reserves have traditionally been classified as "confirmed,"
"recoverable" or "possible" deposits. Figures offered by the Chinese on
their potential reserves may not be stringently attuned to the economic
realities of the oil business. Since the PRC is not too concerned about
profit margins, reserves might be "recoverable" and thus feasible to
develop even if the costs are exorbitant.

A cautious estimate by A. A. Meyerhoff in 1968 stated that China
had 2.7 billion tons of proven and potential oil reserves. Later, he
suggested that the East China Sea could contain another 1.7 billion
tons. By 1976, Meyerhoff had adjusted his figures for China's oil
deposits to around five billion tons or thirty-nine billion barrels, which
also coincided with the conclusions reached in the CIA's June 1977

155 Morrison, supra note 9, at 701.
156 Cohen & Park, supra note 114, at 110.
157 The last official survey taken in 1966 placed total Chinese reserves at seven
billion tons. Kim, supra note 58, at 605.
158 Cohen & Park, supra note 114, at 109.
159 S. Harrison, supra note 115, at 12, 268.
160 Cohen & Park, supra note 114, at 110.
161 Kim, supra note 58, at 605.
study. There have been more positive predictions concerning off-shore oil riches. Over nine billion tons were to be found in the Yellow Sea (Pohai Gulf) region, according to one Japanese estimate, while a Japanese government survey estimated fifteen billion tons would be discovered just around the Tiao Yu-t'ai area.\(^{164}\)

China did not begin exporting oil to the Western industrialized countries (including Japan) until 1973, when one million tons went overseas, out of a total production in the neighborhood of 54.8 million tons. From 1973 to 1977, domestic production increased steadily (reaching ninety-two million tons in 1977), along with the amounts committed to the export market. The 8.8 million tons exported in 1975 dropped to 7.05 million tons in 1976 because of internal political turmoil and the Tangshan earthquake (China diverted its attention to rebuilding the stricken coal industry).\(^{165}\) At the peak in 1975, oil exports provided $910 million in revenues to a country running a $455 million deficit. Even in 1976, China was able to earn $700 million from oil sales, contributing immensely to an overall foreign exchange surplus of $900 million.\(^{166}\) In the first three quarters of 1978 petroleum exports continued to rise rapidly. Exports to the Philippines and Hong Kong showed, respectively, a 75% and an 89.8% increase over the corresponding 1977 period.\(^{167}\) Agreement in 1978 was reached for Japan to import 7.1 million tons, which exceeds the goal set in the LTTA by 100,000 tons. Through the first nine months, Japan had purchased over $535 million worth of Chinese oil.\(^{168}\)

Since the inception of the PRC's oil exportation program, Japan has been by far the major customer. Japan has developed this trade through two consortia of business interests, the International Oil Company, Ltd., and the Importers of Chinese Petroleum Conference. The International Oil Company initiated the trade, since it is comprised of

\(^{163}\) CHINA NEWSLETTER 15 (June 1978). In the CIA's report, China's ultimately recoverable reserves could reach the 100 billion barrel level, taking into account every favorable assumption. Cohen & Park, supra note 114, at 111.

\(^{164}\) For the Yellow Sea (Pohai Gulf) figure, see Kim, supra note 58, at 605. The Tiao Yu-t'ai estimate is in Marine Geologic Investigations of the Offshore Area Around the Senkaku Islands, Southern Ryukyu Islands, U.N. Doc. CCOP/TAG (VI) 32 (1969).

\(^{165}\) CHINA NEWSLETTER 14 (June 1978). These amounts do not include exports to Hong Kong, Singapore and Communist countries.

\(^{166}\) Cohen & Park, supra note 114, at 123.

\(^{167}\) CHINA NEWSLETTER 3 (December 1978).

\(^{168}\) See id. at 7, for the $535 million figure; see also id. at 19 (September 1978), for the agreed on yearly amount.
the leading Japanese oil firms such as Idemitsu Kosan and Maruzen, plus the basic users of Chinese crude, nine electrical power companies and six iron and steel manufacturers.\(^{169}\) Japan was the only Western importer of the PRC's oil in 1973, and has consistently taken up the lion's share of the exported quantities.\(^{170}\)

Crude oil constituted only a 3.3% portion of Japan's total imports from China in 1973, but rapidly rose to a 31.5% share in 1974, a staggering 48.3% in 1975, slumping to 41% in 1976, then improving slightly to 42.3% in 1977, and providing a 38% share in the first nine months of 1978.\(^{171}\) It is interesting to note the slight decline in oil's dominant position among Japan's China imports since 1975. This could conceivably reflect the Chinese desire to diversify its exports, but it most likely demonstrates the concern of Japanese oil interests over the quality of Taching crude. Although Taching crude is low in sulfur it is high in paraffin, necessitating the construction of expensive cracking facilities in order to refine it for general industrial use. Additionally, it has a high nitrogen content which certainly is not conducive to Japanese air pollution control efforts. Because of its elevated "pour point," Taching crude is liable to solidify under normal temperature and pressure, thus requiring constant heating when transported through pipelines. Such heating can be dangerous as the crude also has a low "flash point," meaning that it is volatile.\(^{172}\)

Moreover, Japanese importers have been discouraged by the "heavy" quality of the Taching oil, and the difficulties encountered in extracting the "light" oil components. So far, Taching crude has been distilled to yield less than 30% "light oil," \(i.e.,\) petrol 10%, kerosene 5.4%, gas 13.8%.\(^{173}\) Left with a seventy percent residue of heavy oil, the Japanese have concentrated on using thirty to forty percent of their import volume from China as raw fuel for electrical power and the iron and steel industries.\(^{174}\) The thought of building new facilities to

\(^{169}\) \textit{China Newsletter} 9-10 (January 1978). Figure 2 lists the members of the Japanese consortia. \textit{Id.} at 11. Table 1 gives the amounts accepted each year by the two groups. \textit{Id.} at 9.

\(^{170}\) See \textit{id.} at 13-14 (June 1978), and especially Table 9 for estimates of Peking's exports to Western nations (excluding Hong Kong, Singapore and the Communist bloc).

\(^{171}\) For the 1973 to 1976 statistics, see \textit{id.} at 11 (January 1978); for the 1977 figure, see \textit{id.} at 11 (April 1978); for the 1979 percentage, see \textit{id.} at 7 (December 1978).

\(^{172}\) Cohen & Park, \textit{supra} note 114, at 124.

\(^{173}\) \textit{Id.}

\(^{174}\) \textit{China Newsletter} 12 (January 1978).
further refine Taching crude is doubly unattractive to the Japanese oil industry, because it is already saddled with expensive desulfurizing equipment used in refining the sulfur-laden Middle East crude. Symptomatic of the prevailing attitude in Japanese oil circles was the statement of Masami Ishida, chairman of the Petroleum Association of Japan. He believed that the amount of light oil products refined from Taching crude could only be increased to forty percent, even using the most advanced super-cracking techniques. There was also no guarantee that the PRC would continue to satisfy its obligations under the LTTA by supplying solely Taching oil. Furthermore, China's petroleum was overpriced and not commensurate with its low demand.

In contrast to this negativism among Japanese refiners were the optimistic calculations of Japanese manufacturers. They argued that the specter of another Middle East oil boycott made it advisable for Japan to seek alternative sources of supply. China was the logical substitute with substantially lower transportation costs serving as an added bonus. Even if the PRC no longer exported large quantities of Taching crude, the new super-cracking plants would not go to waste; there is a worldwide trend toward the increased consumption of heavy, "low-gravity" crude oils. Bowing to such reasons, Tokyo decided to construct super-crack facilities at a cost of around $350 billion per year in a joint government-industry arrangement. When completed in 1980, these new plants will have a refining capacity of twenty-six million tons of oil. Speculation has grown that the PRC might be asked to lower the base price of Taching crude in light of this new financial burden imposed on Japanese oil importers.

Despite grumblings about the quality of Taching crude, some Japanese remain confident about the future of Chinese oil production. One perhaps overly-generous projection sees China earning twelve billion dollars in oil revenues in 1988 and producing at least 450

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175 Id. at 13.
177 Compared to the high priced popular Indonesian (Munas) crude, Taching crude was almost 50 cents lower per barrel in 1975 and 1976, but by 1978, the difference was only 30 cents a barrel. See CHINA NEWSLETTER 13 (January 1978), for 1975 and 1976 prices, and Fukui, supra note 97, at 152, for the 1978 figure.
178 Fukui, supra note 97, at 152-53.
179 Id. at 153.
180 Another estimate has suggested that Japan will eventually need 20 such facilities for processing 40 million tons of Chinese crude at a cost of two trillion yen ($10.5 billion). FAR EAST. ECON. REV., October 6, 1978, at 60.
million tons in 1990, but this estimate is based on five conditions: (1) availability of reserves; (2) the use of enormous capital outlays; (3) overcoming problems in oilfield construction; (4) importing the most sophisticated kind of oil drilling equipment; and (5) improvements in related facilities such as the transportation system. A more sober judgment has Chinese oil production between 200 to 300 million tons in 1985, allowing for exports to hit the thirty-to-fifty million ton level, worth between $2.7 to $4.5 billion in foreign exchange.

According to the recent CIA forecast, the greatest risk posed to the future of Chinese oil production is the rapid depletion of the country's main sources of oil. By 1997, the fields in north and northeast China, which presently furnish eighty percent of the PRC's total output, will be dry if the production rate keeps growing ten percent each year. To combat this pessimistic appraisal Peking not only has to find more reserves but must continue to meet the demands of domestic consumption. Domestic use of energy will clearly rise in response to the Four Modernizations program. More oil will be needed for all of the new industrial plants that China is planning to build. Another integral facet of the modernization plan is the mechanization of farming tasks, which also will consume large amounts of oil. Perhaps the most unpredictable element will be the degree of individual consumer demand as the standard of living is boosted by this drive for material progress. Inherent in the PRC's modernization scheme is a dangerous circularity—more oil has to be exported in order to pay for imported technology, which, in turn, requires fuel earmarked for export to be reallocated for domestic industrial use.

Based on a production rate increase of ten percent per year, combined with domestic demand expanding at an annual rate of fifteen percent, the PRC's domestic requirements for oil in 1985 will exceed the production level by about 1.5 million tons. A more sanguine projection of the PRC's ability to meet both internal needs and export targets has assumed an eleven percent annual increase in oil production between 1977 and 1985, with domestic demand growing ten percent per annum and exports at fifteen percent a year. On this basis China will produce 230 million tons in 1985, adequate to cover the

181 Kim, supra note 58, at 606.
182 Chou, supra note 5, at 78, 89.
183 CHINA NEWSLETTER 15 (June 1978).
184 Id. at 14.
185 Chou, supra note 5, at 90.
thirty million tons committed to export markets and the 200 million tons devoted to domestic consumption. Cohen and Park have estimated that oil production will be 145 million tons in 1980 with twenty-five million tons available for export only if oil is used to meet no more than twenty-five percent of China's total internal energy requirements. In order for the PRC to limit domestic use of petroleum, coal production must be stepped up, as it is still the only meaningful alternative energy source. Hydroelectric power satisfies only a minuscule percentage of China's energy needs, and other less conventional sources such as solar energy, geothermal and nuclear power are only in the research and development phase.

Aware of the pressures on the country's oil production capabilities, Peking covets the offshore deposits in the Yellow Sea (Pohai Gulf) area 200 miles east of the capital, since the Tiao Yu-t'ai region is currently off limits. Indicative of these aspirations was the Chinese devoting $500 million in the first half of 1978 to offshore drilling and rigging equipment. Of the $500 million, about one-half of the amount went to American companies, while Hitachi gained a huge order for two of the world's largest jack-up type drilling rigs. Given the exigencies of the situation, China's quest for technical assistance in offshore development probably will include joint venture agreements.

This sort of arrangement was tentatively offered to the Japan National Oil Corporation, which was formed in July of 1978, for the purpose of stockpiling domestic petroleum supplies and backing private firms in their exploration activities. Japan National Oil Corporation was to participate in joint development of the Pohai Gulf area as a separate entity and not merely as the representative of private interests. Of course, in China's rush for technical assistance in offshore drilling the Japanese will face tough competition from the United States. In 1978, Peking invited delegations from four large American companies.
companies—Pennzoil, Exxon, Union Oil and Phillips Petroleum—to discuss proposals on offshore development. American spokesmen have claimed a possible investment of twenty-five to fifty billion dollars by United States oil interests in China, within the framework of a profit-sharing plan. The Japanese would have mixed feelings about a massive influx of Western financial and technical support in the development of China's oil reserves. On the one hand, as more oil is discovered, it would become easier for Peking to meet the export goals of the LTTA, but China, on the other hand, could be obligated to divert substantial amounts of oil away from Japan to her other Western partners.

Hampering the implementation of the PRC's oil export plans are the transportation bottlenecks endemic to the major oil fields. China is currently plagued by extra long pipelines, insufficient storage facilities, a poor railroad network and ports which until recently could not accommodate large oil tankers. One of the motivations behind the development of the Pohai deposits is the hope that an offshore transportation system will be easier to sustain, since the crude oil could be directly loaded onto ships at the offshore site, thus obviating the problem of congested ports. By July of 1976, the port situation was somewhat rectified by the construction at Talien of a berth capable of receiving large oil tankers in the 50,000 to 100,000 ton range. In addition, a new pipeline was constructed connecting Talien with the Taching oil complex and a further pipeline link went from Taching to the Peking refinery.

Although oil clearly is the key item in the PRC's export trade to Japan, its importance for Japan must be viewed in proper perspective. Even if China would sell forty million tons to Japan in 1980 (far beyond the target set in the LTTA), this would make up only fifteen percent of Japan's total needs. Probably the most significant long-term effect will be to make the PRC more reliant on Western technical cooperation and financial assistance.

B. Ordinary and Coking Coal

Coal is the PRC's primary source of energy, and has been relied upon in the past to provide up to ninety percent of the nation's energy.

193 FAR EAST. ECON. REV., October 6, 1978, at 60.
194 CHINA NEWSLETTER 14 (January 1978).
195 Chen, supra note 7, at 43.
196 Cohen & Park, supra note 114, at 128.
needs. To alleviate this pressure on the dwindling supplies of coal, attention was directed towards development of the petroleum industry so that by 1974 coal provided sixty-six percent of the country's energy consumption. Because of the calamitous Tangshan earthquake in 1976, which devastated China's largest mine located at Kailuan, efforts were made to find new coal sources. One such source was discovered in Anhwei Province. Seeking to modernize and expand their coal facilities in order to meet the goal established in the Ten Year Plan of doubling coal production by 1985, the Chinese have welcomed Japanese cooperation on a vast scale.

Beginning in 1974, Japan started importing either the Zhunpei or Tatung variety of ordinary Chinese coal, used chiefly to fuel electrical power plants. From 1974 through 1976, Japan imported a total of 335,000 tons, averaging about 100,000 tons a year. Unfortunately, the quality of PRC coal was somewhat mixed: Zhunpei coal has a low sulfur content but also low caloric value, while Tatung coal is characterized by questionable burning properties. In addition, the Japanese were not happy about the coal's relatively high price tag.

An overriding restraint on the present Japanese capacity to import ordinary coal is a lack of domestic demand. In order to accommodate the progressively increasing pace of ordinary coal purchases from China in the later years of the LTIA, Japan will have to improve and expand its cargo handling facilities for foreign coal haulers, since it had always been assumed that the domestic supply of coal would be sufficient to cover the nation's requirements. This situation will be drastically changed if a new giant electrical power station is completed by 1982 at Matsushima, requiring 2.4 million tons of coal yearly, with the Chinese slated to provide one million tons of this volume.

Although Japan imported as much as 920,000 tons in 1967, by

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197 V. SMIL, supra note 187, at 145.
198 Cohen & Park, supra note 114, at 118.
199 The first offer of assistance came from an instrumentality of the Japanese government, the International Cooperation Agency, which was willing to bear the monetary costs of exploring for new mines. Asahi Evening News, August 15, 1978. As of December 1978, negotiations were still continuing, but now it seems that the Japan Coal Association is the principal Japanese party in the proposed joint venture. CHINA NEWSLETTER 21 (December 1978). In addition, since the signing of the LTIA, the Japanese have agreed to provide the PRC with a full range of coal-related equipment and plant facilities. Id. at 18-20.
200 CHINA NEWSLETTER 17 (January 1978).
201 Id.
202 Id. at 14.
1969 it had stopped importing any Chinese coking coal, which had previously been consumed by iron and steel mills. Among the causes for this cessation in trade were worries about the coal's quality, i.e., the Kailuan variety, and a great slowdown in domestic demand. Conscious of Japanese complaints about Kailuan coal, the Chinese agreed in the first year of the LTTA to divide their 300,000 ton shipment of ordinary coal between Kailuan and a mine in Shantung Province. On the issue of price, the PRC bargained for a forty-nine dollars per ton figure, but finally agreed to forty-five dollars per ton, which was still higher than the price charged for comparative Australian and Canadian types of coking coal. Considering the rather weak domestic demand, it is somewhat unclear how Japan will be able to absorb the quite substantial amounts of coking coal targeted for the 1980 to 1982 segment of the LTTA.

VIII. SINO-JAPANESE TRADE OUTSIDE THE TERMS OF THE LTTA

A. Chinese Exports in the "Ordinary Trade"

While the Chinese exports under the LTTA have attracted the most comment, the volume of ordinary trade (OT) exports to Japan outside the parameters of the LTTA is and will continue to be impressive. Chinese textile exports alone constituted around forty percent of total exports to Japan in 1972 and 1973, close to twenty percent in 1976 and 1977, and over twenty-five percent in the first three quarters of 1978. Meanwhile, the agricultural sector and the fishing industry accounted for over forty percent of net Japanese exports in 1972, more than thirty percent in 1973, and around twenty percent in 1977 and through the first nine months of 1978. Predominent items were seafood, vegetables such as chestnuts and soybeans, and grain, primarily rice.

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203 Id. at 17, 18.
204 Id. at 20 (September 1978).
205 See id. at 10 (January 1976), for a listing of the principal export and import commodities in Sino-Japanese trade during 1972 through 1974; see also id. at 15 (April 1978), for similar statistics in 1976 and 1977; see also id. at 11 (December 1978), for the 1978 figures.
206 Id.
207 Especially remarkable is the PRC's newly gained position as the world's greatest rice exporter. From 1973 to 1975 alone, the volume was more than three million tons a year, providing an average of $900 million annually. Chou, supra note 5, at 68.
Even though the percentage of China's exports devoted to the OT area will decrease over time, the OT exports will always be a stable aspect of Sino-Japanese trade. Most of these commodities enjoy an entrenched position in Japanese markets, because they consist, for the most part, of products for daily use. Based on an expansion in volume of between five and ten percent per year, OT goods will account for close to one billion dollars of the projected $1.6 billion worth of China's exports to Japan in 1978. Because of the increasing impact of the LTTA, the OT amount will approach $1.1 to $1.4 billion in 1982, still about one-third of the total exports, estimated at $2.7 to three billion dollars.

A dark cloud hanging over the textile industry in China is the growing trend toward protectionism in its key markets—Japan, the United States and the European Economic Community nations. Increased sales to Communist and developing nations is not a terribly appealing option, since their ability to pay for these products in hard currency is restricted. Raw silk had always been the pillar of China's textile trade with Japan, at its heights in 1973 securing nearly a twenty percent share of the total exports to Japan. But during the 1974 to 1975 period, sales of raw silk took an abysmal plunge, falling almost ninety percent at one point. Subjected to domestic pressure, the Japanese had passed new legislation drastically reducing the amount of silk to be imported. However, the raw silk trade rebounded, dramatically assisted by the signing of a Japan-China agreement on silk imports in 1977. As a trade off for Chinese reductions in the sale of manufactured silk items to an already saturated Japanese market, the Japanese accepted larger compensating quantities of raw silk. Japan's erratic reactions towards Chinese raw silk imports illustrate in a nutshell how textile trade is so delicately impinged upon by internal political considerations.

B. Japanese Exports Using the OT Route

Among the various Japanese OT export commodities, the perennial leader has been metal products with iron and steel preminent. Certain

208 CHINA NEWSLETTER 21 (June 1978). For instance, in 1976, when China's total exports to Japan fell off 10.5% as compared to 1975, China's exports in OT categories improved 2.6% over the previous year. Id.

209 Id. at 21 (June 1978).

210 Id. at 11 (January 1976).

211 Id.

212 Id. at 12 (April 1978).
steel products regarded as construction material (bars, pipes and tubes) are included in LTTA trade figures, but the great bulk of items employed in manufacturing, such as steel plates, are considered OT exports.\textsuperscript{213}

From 1968 through the early 1970's Japan exported about one million tons of iron and steel each year to the Mainland, making the PRC Japan's second best customer after the United States.\textsuperscript{214} By the mid-1970's a stagnant domestic iron and steel industry forced Peking to import more than three million tons annually.\textsuperscript{215} Japanese predictions were that the PRC could possibly overtake the United States as Tokyo's main purchaser in 1978, buying more than 4.5 million tons.\textsuperscript{216} With iron and steel products leading the way, the metals industry in Japan since 1976 has held on to slightly more than a fifty percent share of all exports to China.\textsuperscript{217} Considering the frenetic tempo of China's industrialization movement, this percentage should remain firm for quite some time until China's own iron and steel facilities are renovated and expanded.

The other major area in Japan's OT exports has been chemicals, in particular fertilizer, to meet China's immense agricultural demands.\textsuperscript{218} Large quantities of fertilizers were shipped to the Mainland in the early 1970's, with the PRC becoming the world's greatest importer of nitrogen fertilizer in 1972 (Japan providing seventy-nine percent of this amount).\textsuperscript{219} Since that time the quantity has steadily fallen, with orders being placed for about two million tons in 1978.\textsuperscript{220} Sales have not returned to early 1970 levels because of increased domestic consumption in Japan and Chinese preoccupation with the more glamorous high technology items of Japanese exports. Furthermore, it is possible that the construction of fertilizer plants, especially during the 1972 to 1974 period, enabled the Chinese to reduce their

\textsuperscript{213} Extrapolating from an assumed annual growth rate of 10% to 15%, these OT products will provide Japan with $1.5 to $1.6 billion of its total $1.9 to $2.0 billion worth of exports in 1978, and will maintain their dominance in 1982 with a 60% and more share of all exports ($2.0 to $2.5 billion out of $3.4 to $3.9 billion). \textit{Id.} at 20 (June 1978).

\textsuperscript{214} Kim, \textit{supra} note 58, at 608.

\textsuperscript{215} Chou, \textit{supra} note 5, at 67.

\textsuperscript{216} \textit{China Newsletter} 6 (December 1978).

\textsuperscript{217} \textit{Id.} at 15 (April 1978), reveals the figures for 1976 and 1977; \textit{see id.} at 11 (December 1978), for the 1978 statistics.

\textsuperscript{218} The other major components of the chemical trade have been plastics, artificial resins and organic chemicals.

\textsuperscript{219} Kim, \textit{supra} note 58, at 612.

\textsuperscript{220} \textit{China Newsletter} 5 (September 1978).
dependency on foreign sources of supply.\textsuperscript{221} After a three year hiatus, the PRC in 1977 again became interested in building new facilities, with a Chinese delegation visiting several European companies specializing in fertilizer plant construction.\textsuperscript{222} Since late 1977 two Japanese firms have been negotiating with Peking on supplying the equipment and technical assistance for a new fertilizer plant project.\textsuperscript{223}

Viewed statistically, the whole chemical sector has declined in importance through the 1970's. Chemicals represented a 32.6\% share of total Japanese exports to China in 1972, and by the first half of 1978, this share had fallen to 14.5\%.\textsuperscript{224} What the Japanese have done is to switch from the export of individual chemical substances and agents to supplying petrochemical facilities which will provide China with a wide variety of chemical products.

IX. JAPAN'S EXPORT OF INDUSTRIAL PLANTS AND CONSTRUCTION MACHINERY AND EQUIPMENT UNDER THE LTTA

Since normalization, Japan has consistently been the main supplier of industrial plants to the PRC. From 1972 through 1977, the Japanese received about one billion dollars, or one third of China's total investment in this area.\textsuperscript{225} In the 1972 to 1976 period, the bulk of Japan's plant exports were primarily in the petrochemical sector, then in iron and steel, followed by electrical power plants, with petroleum facilities playing quite a minor role.\textsuperscript{226} Throughout the 1970's, China's volume of plant importation and purchases of machinery and equipment mirrored very closely the fluctuations in its general trading patterns.\textsuperscript{227}

\begin{footnotesize}
\textsuperscript{221} Heymann, \textit{supra} note 71, at 29.
\textsuperscript{222} Yeh, \textit{supra} note 20, at 11.
\textsuperscript{223} CHINA NEWSLETTER 20 (December 1978).
\textsuperscript{224} Id. at 10 (January 1976), for the 1972 percentage, and id. at 35 (September 1978), for the 1978 figure.
\textsuperscript{225} See id. at 6 (September 1978), where Table III breaks down the PRC's purchases country-by-country for the years 1972 through 1977. Japan sold $1.017 billion to the Mainland, out of a total of $3.148 billion, with France and Switzerland combined in second place ($670.6 million) followed by West Germany, and the United States was a poor fourth with only $290.8 million in sales.
\textsuperscript{226} FAR EAST. ECON. REV., August 19, 1977, at 39.
\textsuperscript{227} Japan's total exports of plant facilities and machinery and equipment hit a peak in 1975, with over $697 million worth purchased by Peking (over 30\% of Japan's total exports to China). See CHINA NEWSLETTER 16 (September 1978), for a yearly survey of such Japanese exports to the PRC from 1973 through the first half of 1978. After a sharp decline in 1976 and 1977, in the first nine months of 1978 the amount rose to $395.3 million, a 197\% increase over the corresponding 1977 period, and about a 20\% share of Japan's total exports to the Mainland. Id. at 6 (December 1978).
\end{footnotesize}
Upon conclusion of the LTTA, Japanese involvement in plant importation intensified. One Japanese estimate predicts that if all the proposed plant contracts are signed, the total value will be in the thirty to forty billion dollar range.\textsuperscript{228} Already in the first nine months of 1978, firm contractual commitments for Japanese plant exports to the PRC had reached the $486 million level, with many deals still in the negotiation stage.\textsuperscript{229}

By far the most substantial agreement to be formally concluded in 1978 was Nippon Steel’s plan to help construct an enormous new steel mill at Paoshan near Shanghai for a cost of $2.03 billion.\textsuperscript{230} This giant complex will produce six million tons of steel annually, and is of particular interest to China, because it will be its first steel mill located near the sea, thereby easing transportation costs.\textsuperscript{231} Other large Japanese steelmakers are still negotiating over their role in Chinese schemes to build even larger steel facilities at Chitung in Hopei Province (projected capacity of ten million tons a year) and at Anshan in Liaoning Province (projected capacity of fifteen million tons a year).\textsuperscript{232} In addition, Japanese firms will probably assist in the renovation and expansion of existing Chinese steel mills in Peking, Wuhan, and Liaoning Province. All this activity is motivated by the PRC’s goal under the new Ten Year Plan to raise steel production from its present twenty-five million tons to fifty million tons by 1985.

One of the earliest deals to be concluded under terms of the LTTA was Kararay Company’s commitment to construct a plant for the manufacture of synthetic leather, valued at around twenty-four million dollars. Later in the Summer of 1978 a package of plant contracts was signed covering the vital components of color television sets, a cathode ray tube facility to be completed by Hitachi and Toshiba, a glass plant to be provided by Asahi Glass, and an integrated circuit factory to be built by Toshiba. In conjunction with these contracts a group led by Matsushita Electric will construct two color television assembly plants.\textsuperscript{233} The PRC is obviously interested in entering the highly competitive field of consumer related electronic products, currently dominated by its Asian neighbors (Japan, Taiwan and Hong Kong).

\textsuperscript{228} Asahi Evening News, August 17, 1978, at 5.

\textsuperscript{229} CHINA NEWSLETTER 7, 18-20 (December 1978). For more detailed discussion of particular projects, see id. 11-19 (September 1978).

\textsuperscript{230} N.Y. Times, October 6, 1978, § A, at 1; id., October 6, 1978, § D, at 16.

\textsuperscript{231} CHINA NEWSLETTER 11 (September 1978).


\textsuperscript{233} CHINA NEWSLETTER 20 (December 1978).
But the activity in the color television area should not be strictly construed as a vehicle for China's export trade—it might also be a signal that China is anxious to begin providing a limited number of luxury items for domestic markets.

In the petrochemical area, two significant ethylene plant agreements were signed in 1978. At Taching, for a cost approximating twenty-five billion yen, Marubeni Corporation and Japan Gasoline Company agreed to provide both the facilities and the technology. The other plant, to be located at Chilin, will see the Chinese in charge of design with the Japanese group, headed by Mitsubishi Corporation, furnishing the equipment and technology. A noteworthy feature of the Chilin project was that for the first time, the PRC had accepted a Japanese trading company, Mitsubishi, as a formal contracting party.\(^{24}\) Such a concession indicated an increased Chinese appreciation of the unique position in Japanese economic life held by the Japanese trading conglomerates.

Negotiations are being conducted with Toyobo and Kanebo for the construction of twin plants designed to manufacture polyester. When completed, the output of these plants could equal Japan's total present production.\(^{25}\) This astonishing possibility also demonstrates the long-range challenge that China's developing textile industry poses to the Japanese enterprises which are currently helping to modernize its obsolescent facilities. These Japanese firms are caught in a cruel dilemma—the opportunities in China for large, quick profits are very seductive, but once Chinese technology is improved, the PRC's finished products could undercut Japan's already faltering textile industry, especially in light of the low labor costs on the Mainland.

Acutely aware of its increased power needs for industrialization, China has concentrated on expanding its energy potential. Besides heavy involvement in coal development projects, the Japanese have been asked to provide technical assistance in the construction of nuclear power facilities and in the analysis of the gas distribution systems in urban centers such as Peking and Shanghai.\(^{26}\) Japanese advice also has been solicited for the revamping of the PRC's fallible electrical power network, especially regarding its lack of an adequate long-distance transmission system.\(^{27}\) Faced with the idea of themselves

\(^{24}\) *Id.* at 12 (September 1978).
\(^{25}\) *Id.* at 19 (December 1978).
\(^{26}\) *Id.* at 21.
\(^{27}\) *FAR EAST. ECON. REV.*, July 7, 1978, at 36.
building super-cracking plants to refine China's Taching crude, the Japanese have sensibly suggest as another alternative, the development of such sites on the Mainland, with Japan to supply around 200 billion yen worth of equipment.238

In 1978, the PRC not only bought oil rigs from Hitachi, but also purchased two underwater exploration ships and five oil recovery vessels all for use in offshore drilling.239 Hitachi also received a request for a computer specifically designed for geological prospecting, which could be used to scan for oil in the continental shelf regions. This proposed $4.3 million computer sale raises the tricky question of the transfer of sensitive technology, since Hitachi must first secure the approval of COCOM.240

X. TRANSFER OF TECHNOLOGY TO THE PRC

A. Prototypes, Plant Importation, Licensing Arrangements

In the past, perhaps the most standard approach taken by China in absorbing advanced technology was the utilization of the foreign prototype model. At the conclusion of international industrial fairs held on the Mainland, the Chinese would shrewdly purchase the display models from foreign exhibitors, and proceed to manufacture their own domestic versions without any outside assistance. Though a cheap way of accepting Western technology the prototype procedure was seriously flawed. Duplicating the most advanced technological items would be an extraordinarily difficult task probably beyond Chinese capabilities, since it demanded a sophisticated level of design engineering, precision in parts manufacturing, and the acquisition of the proper building materials.241 Gradually the Chinese recognized the inherently counterproductive aspect of the prototype method, which only masked their own technical deficiencies. Fundamentally, a prototype "by itself reveals only what was produced, not how it was produced."242 The imitator proves he can copy an existing model but does nothing to stimulate his abilities to generate new technological designs or processes.

238 China Newsletter 20 (December 1978).
239 Id. at 17-18 (September 1978).
240 Coordinating Committee for Exports to Communist Areas of the NATO Consultative Group in Brussels (includes all NATO countries except Iceland, while adding Japan as a member).
241 Heymann, supra note 71, at 27.
242 Id.
A more effective means of technology transfer was the plant importation approach. Traditionally on the basis of self-reliance, the PRC, in importing comprehensive packages of plant assembly and equipment, shunned the accompanying benefits of on-site consultation and supervision.243 By denying themselves the continual technical services of foreign experts the Chinese were perpetuating their backwardness in the sphere of "management technology."244 They were deprived of those insights offered by foreign technicians concerning plant management and production organization, which are gained only through experience. Preliminary indications in 1978 pointed to an attempt to correct this benighted policy. Acceptance of the full array of foreign technical assistance seems to be an integral element of the proposed Sino-Japanese cooperative ventures in the energy field. Plans for Kuraray's artificial leather plant call for forty Japanese engineers in charge of construction and technical guidance to be stationed in China, while in return, fifty Chinese will be given technical training in Japan.245 Part of the Japanese responsibility in the Marubeni-Japan Gas ethylene plant project was the training of Chinese operators to oversee the facility's computer system.246

After visiting the PRC in 1977, Norman Macrae, an editor of the London Economist, decried the tendency of developing nations like China to buy their way to industrial progress through complete plant importation contracts, with one foreign party supplying all the facilities and equipment. As an alternative, he recommended the importation of "six or seven competing brands of foreign technology within each Chinese industry, so that there can be experiment to find what modified versions of which two or three are best-suited to Chinese conditions."247 Not only will this approach give the Chinese more discretion and control over the adoption of foreign technology, but also will lead to lower costs, since foreign companies will engage in price slashing in order to attract PRC purchasers. In 1978, the PRC took this advice to heart. As an example, most of the major Japanese steelmakers were diversifying into a wide spectrum of projects, ranging from the construction of new mills to the improvement of outmoded existing facilities, involving a great amount of subcontracting. In the color television assembly area, components were being supplied by

243 Id. at 28.
244 Id. at 31.
245 CHINA NEWSLETTER 12 (September 1978).
246 Id. at 13.
247 ECONOMIST, December 31, 1977, at 22.
several different Japanese electronics firms, while a similar division of labor also was employed in the building of petrochemical plants. The ethylene plant deal entered into by a Mitsubishi-led consortium graphically illustrated China's new insistence on separate purchases of plant equipment and machinery. The Mitsubishi group was responsible for the manufacturing of boilers and electrical equipment, Marubeni and Japan Gas were to help supply chemical storage tanks, and Ishikawajima-Harima would build compressors.248

Mr. Macrae also believed China should institute a licensing system for the acquisition of new technology, since it is the "only way that foreign companies can be persuaded to leave technicians in China with an interest in getting a process working."249 A foreign corporation would grant the Chinese a license to use a certain technical process, and agree to be partially repaid "according to the sales made of products from the process within China."250 This type of economic incentive will compel a foreign firm to provide the proper degree of plant supervision. A concrete example of this approach was the license given to the Chinese for the process of extracting butadiene (using natural gas) as part of the Marubeni-Japan Gas ethylene plant agreement.251 Teng Hsiao-ping's product payback method also could have the same desirable results as a licensing system—a completed plant's output would be used to repay a foreign company for the plant technology supplied. Evidence of this business strategy in operation can be gleaned from Peking's encouragement of provincial efforts to introduce such product payback schemes.252

B. Patent Rights and COCOM Restrictions

One reason that foreign corporations favored selling complete packages of technology to the PRC was the concern over the protection of their patents. With the Chinese predilection for copying technology in disregard of patent rights, foreigners viewed the "turnkey" project as relatively immune from such pirating activity, since there was so much technical information to be assimilated all at once.

Hostility toward the Western concept of patent law is deeply ingrained in the PRC's political philosophy. Inventions are created by
the revolutionary zeal of the masses and therefore are the property of the state. Rejecting the principle of “private ownership of knowledge,” an editorial in the *People’s Daily* commented that “[i]t is not necessary for us to regard the inventions and technological improvement of a certain individual or a certain unit as personal property which deserves protection! This is different in nature from the so-called ‘patent rights’ under the capitalistic ‘system.’”

In the PRC’s infancy, provisional regulations closely paralleling Western models established alienability of patent rights. However, by 1954, a schedule of monetary awards was introduced to replace the earlier rules, and no mention was made of patent rights. Promulgation in 1963 of the “Regulations on Awards for Inventions” and “Regulations on Awards for Technical Improvements” totally ignored the personal property aspect of patents. A revised monetary compensation plan was outlined, fixing the payment amount instead of having it calculated as a particular percentage of an invention’s production value. All inventions were treated alike with no recognition of their different individual benefits.

Jen Chien-hsin’s 1977 interview in the *China Quarterly* clearly indicated that the new leadership in Peking was very sensitive to foreign complaints about China’s parasitic use of technical knowledge. He hinted that the PRC was examining the possibility of registering patents and also of subscribing to international patent conventions. In an attempt to ease foreign anxieties, Jen stated that China would not copy patents without specific authorization. Since individual business contracts were signed by state-owned trading corporations, the Chinese government would ensure that foreign patent rights were not violated. Reiterating the respect the PRC had for foreign investors’ individual property rights, Jen argued that even though patents were not currently registered, “[w]e solve the problem by putting a certain clause into the contract. We protect rights, but the method of protection is different.” Jen was probably referring to those individual contracts in China’s foreign trade practice which had prohibitions on technical knowledge being transferred to third parties.

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254 Id. at 336-37.
255 Heuser, *supra* note 84, at 163.
256 Id.
More dramatic evidence of Peking's altered policy toward patents has been the recent Japanese reports of Chinese intentions to enact a new series of commercial laws in 1979 including a "patent act."\textsuperscript{258} The proposed Chinese legislation appears to only protect foreign technical knowledge and does not consider the question of domestic invention. If Peking wants to stimulate and encourage the spirit of scientific experimentation and innovation within China, the 1963 "award" regulations must be revised. As part of the Ten Year Plan, 800,000 new scientists are to be trained. This goal could prove to be meaningless unless this new generation is more amply rewarded for individual technical improvements.

COCOM restrictions are intended to prevent the transfer to Communist nations of technology which has military application. Japanese exports to the PRC have been hampered by these curbs, especially at the instigation of the United States, which provides Japan with so much of its military security. Deliberations in COCOM are very time-consuming and laborious because each country has the prerogative to veto the sales of a fellow member.\textsuperscript{259} Acting in concert with several European nations, Japan managed to get some fifty items removed from the COCOM restrictive list in 1972.\textsuperscript{260} Japanese distaste for COCOM trade roadblocks had already been exhibited in a 1969 judicial decision declaring the enforcement of COCOM regulations through the Japanese foreign exchange control law as an illegal act. Since the Diet had not passed any statute implementing the COCOM proscriptions, the foreign exchange control act, reasoned the court, could not be used to circumvent this legal deficiency.\textsuperscript{261}

A prominent case of COCOM's impact on Sino-Japanese trade was the Japanese sale of large-scale computers to the Mainland, initially ordered in October of 1976. Hitachi was to supply three computers designed for meteorological observation. Before permitting the sale, the United States forced Tokyo to accept three COCOM preconditions: (1) reduction of the computer memory capacities; (2) the creation of a safeguard system preventing diversion to military use; and (3) the monitoring of computer operations through an inspection system. Following negotiations with the Chinese, Hitachi was permitted to reduce the storage capacity by cutting down on the data processing

\textsuperscript{258} N.Y. Times, December 9, 1978, § A, at 1.
\textsuperscript{259} FAR EAST. ECON. REV., October 6, 1978, at 57.
\textsuperscript{260} Henderson & Matsuo, supra note 90, at 64-65.
\textsuperscript{261} Id. at 65-66.
speed of the computers, having the computers connected to the Tokyo Meteorological Agency as part of the safeguard system, and dispatching its own employees to be on-site inspectors for three to four years. The inspectors would report to COCOM any irregularities in computer use. Finally, after almost two and one-half years of tortuous discussions, COCOM formally approved the transaction on February 8, 1978.

COCOM's rather labyrinthine procedures may not be as much a hinderance to China's proposed purchase of a geological survey computer from Hitachi. The United States has softened its attitude toward the application of COCOM restrictions to exports bound for the PRC. In 1978, Washington decided not to insist on COCOM authorization for a $2.8 million sale of American geological prospecting equipment to the Mainland. According to some Japanese sources, the United States also may not ask for COCOM approval of IBM's planned sale of a production management computer system for a turbofan plant in Shenyang. In light of equitable considerations, it could be difficult for the United States to argue for full COCOM review of Hitachi's proposed sale.

Despite COCOM barriers, China was able even in the past to import equipment with overt military potential. In 1975, Peking was licensed by Rolls Royce to manufacture Spey engines designed for use in fighter aircraft. Purchasing new weaponry is a vital part of the PRC's current military modernization program. Peking has evinced interest in buying from the French sophisticated missiles such as the Crotale and Exocet, in acquiring the Franco-German HOT and MILAN antitank missiles, and obtaining from the British the versatile Harrier jump jet. Only recently, Washington has reversed its longstanding policy against the sale by its allies of "defensive" arms to China. It has been suggested that COCOM clearance will be waived if the weapons to be sold are clearly in the "nonthreatening" category. Already in 1978, the English were able to sell diesel engines for use in Chinese coast guard vessels, without seeking the green light from COCOM. A concern for Japanese trading interests is that the PRC will repeat the mistakes of so many developing nations, by embarking on an overly ambitious military spending campaign, thus diverting funds away from industrial projects involving Japanese investment.

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262 Nihon Keizai, December 30, 1977, at 8.
263 See supra note 20, at 12; FAR EAST. Econ. Rev., October 6, 1978, at 55-56.
265 Id.
XI. PRC'S FINANCING TECHNIQUES

A. Traditional Methods

One of the problems faced in determining how the Chinese will pay for their new lavish modernization program is their rather cryptic and secretive approach to the whole issue. Details of the PRC's financial condition are scarce, and Peking has never revealed any comprehensive blueprints on the financing of its import plans. To the Chinese, their financial standing in the world community is a sensitive question. Chinese pride in being self-reliant makes it difficult for the PRC to confess owing a debt to any foreign nation. In the past, the PRC steadfastly refused offers of foreign aid, direct government loans, and foreign investment through joint ventures, not wanting to emulate the experiences of so many debt-riddled developing countries. However, in 1978, the Chinese were extraordinarily receptive and amenable to new methods of financing, with their thinking evolving rapidly on an ad hoc, case-by-case basis.

Statistics gathered by the Swiss-based Bank of International Settlements (BIS) have been very useful in gauging the relative financial position of China on the international level. BIS, which serves as the clearinghouse for the central bankers of the industrialized nations (including Japan), is able to extract lending figures from commercial banks, revealing the debt situation in various countries. Liabilities incurred by members of BIS with the Bank of China (Peking's central bank) increased from $1.4 billion in 1976 to $2.4 billion at the end of September 1977.\(^\text{267}\) Compared to these reserves, China's foreign bank borrowings were put at around $500 million. More unsettling is the BIS estimate that 85.7% of this "debt" would come due in 1978.\(^\text{268}\)

Among the credit techniques commonly employed by the Chinese in their trade with Japan are mutual deposits of third country currencies, the revised yen-yuan agreement of 1973, progress payment plans, and deferred payment schemes (applicable to the import of plant facilities and equipment under the LTTA), often relying on suppliers' credit. Based on a fairly conservative figure of the PRC importing an average of three billion dollars over the next few years, this would make it imperative for China to at least double its present yearly ex-

\(^{267}\) Yeh, supra note 20, at 3.

port earnings of seven billion dollars in order to continue using suppliers' credit.\(^\text{269}\) Suppliers' credit has been a favorite source of funds for the Chinese, because in their view they have accumulated no debt. Since the foreign supplier was charged with the responsibility of procuring financing, he was regarded as the debtor. To be able to accept delayed payments from the Chinese buyer, the foreign exporter would obtain low interest rate credit from a bank, with the national government often guaranteeing the bank from risks of nonpayment.\(^\text{270}\) When supplier's credit is tied in with a deferred payment plan, the seller is usually given a down payment of around twenty percent and is paid at regular intervals over a five year period, which only begins to run after the imported plant facilities have been completed.\(^\text{271}\) In reality, the foreign supplier is providing a medium-term loan to the Chinese, who have even agreed to pay moderate interest charges.

While deferred payment operations accounted for more than sixty percent of all PRC plant financing in the 1972 to 1976 era, the rest of the projects involved "progress payment" methods. First, came a twenty percent down payment, with seventy percent of the total sum being paid out as the equipment was being installed, and the final ten percent being paid after the plant had functioned for one year.\(^\text{272}\) If used extensively, progress payment deals could cause severe cash flow problems for a fiscally prudent country like China.

Until the August 18, 1972 yen-yuan agreement, Sino-Japanese trade contracts were payable only in English pounds. Japanese discontent over this arrangement grew as the PRC granted other Western nations the right to deal in their own currencies. Japanese hardship, caused by the weakening pound, was eased by the non-governmental yen-yuan accord entered into by the Bank of China (BOC) and the Bank of Tokyo. Yen and yuan were now acceptable currencies of payment, and the Japanese were willing to have their China trade surpluses expressed in yuan instead of the stronger yen, so long as the BOC would buy back the excess accumulation.\(^\text{273}\) The 1972 yen-yuan pact was revised in August of the next year. In this new agreement the importing party was given the option of choosing the currency of pay-

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\(^{270}\) Id., September 23, 1977, at 40.


\(^{273}\) Henderson & Matsuo, supra note 90, at 62.
ment, but in practice, yuan (or RMB) became the monetary standard for all of Japan's exports to China and for eighty to ninety percent of its imports from the PRC.

According to the terms of the 1973 yen-yuan settlement, the BOC was given the privilege of unilaterally establishing the yen-yuan exchange rate, the "official rate," controlling the yen account of the BOC in the Foreign Exchange Bank of Japan, and the latter's yuan account in the BOC. Balances in both accounts were converted into British pounds at the prevailing market rate, and could be used to pay off contractual commitments in Sino-Japanese trade. The Japanese, by not insisting on having their yuan deposits directly convertible into yen, were continuing to deny themselves all the benefits of their currency. The PRC was further assisted by Japanese reluctance to draw on their growing yuan account in the BOC. By not using these amounts amassed by virtue of their favorable trade balance with the Chinese, the Japanese were, in effect, giving the PRC temporary interest free loans.

In addition to the yen-yuan procedure, the two countries also employed mutual deposits of third nation currencies. It was not surprising that this mechanism also allowed the PRC to gain more financial leverage. Deposits were made in the overseas branches of the Bank of China and in individual Japanese banks. Generally, the amounts placed by the Japanese in BOC branches greatly exceeded the reciprocal sums deposited by the BOC in Japanese banks. In taking advantage of the resultant discrepancy, the BOC could borrow the surplus amount in its overseas branches to help pay off China's import bill. It has been rumored that in late 1975, Japanese banks had amassed a surplus balance of nearly $100 million in just the London office of the BOC.

A variation on this mutual depositing technique was the deposit of equivalent amounts of yen and yuan. Since the RMB (yuan) was a non-convertible currency, the BOC could borrow the yen at no interest while applying the RMB as collateral.

There also was an "arbitrated rate" determined by a complex system of cross-rates among the RMB-pound, the dollar-pound and the yen-pound. If this rate dropped below the "official rate," Japanese exporters could be hurt by the resulting devaluation of the RMB, since they were using the yuan as their currency. Denny, supra note 271, at 174.

Tsuchiya, supra note 1, at 245-46.

Denny, supra note 271, at 170.

Yeh, supra note 20, at 14.

Id.
mutual depositing schemes the Chinese also were able to secure another financial advantage. Often they were allowed to overdraw their accounts at minimal interest rates, with the Japanese banks normally not placing any restrictions on the amount and duration of the overdrafts.\textsuperscript{279}

Despite these ingenious financing devices, China's future capacity to absorb dramatic increases in its debt load, caused by enormous import orders, is open to question. David Denny, a noted commentator on Chinese financial affairs, felt that the PRC could maintain a rather conservative repayment ratio of fifteen percent (as compared to the country's net export earnings) in 1980, if about one billion dollars worth of plants financed according to deferred payment schedules were purchased annually, and if the volume of exports grew at a rate of ten percent a year.\textsuperscript{280} His relative optimism was contingent upon there being no large-scale need for agricultural imports.\textsuperscript{281} In a revised estimate, Denny noted that the combined debt servicing on imports of agricultural commodities and industrial plants would be only nine percent in 1980, if a modest five percent was achieved in the years 1976 through 1980.\textsuperscript{282} Two factors should be pointed out—Denny only considered Chinese plant imports through 1976, and he assumed that the PRC would only import one billion dollars a year in plants, which in light of the LTTA, is too low a figure.

More current and somber analysis of the PRC's financing capabilities was provided by the Japan External Trade Organization (JETRO).\textsuperscript{288} The PRC's repayment commitments will exceed revenues by almost $300 million in 1979 to 1981, based on a five year deferred payment formula, the current prices of Chinese exports, and the ordering of eight billion dollars worth of plant imports between 1978 and 1980. This situation would improve in 1982, when China would enjoy a surplus of over $150 million, and this favorable trade balance would continue into 1983 through 1985, based on expected increases in the quantity of its LTTA exports. What might help resolve the early cash-flow quandary for the PRC would be more generous financial terms, \textit{i.e.}, a ten year deferred payment plan, and a five percent yearly increase in price of leading export items.

\textsuperscript{279} FAR EAST. ECON. REV., May 27, 1977, at 78.
\textsuperscript{280} Denny, \textit{supra} note 271, at 180.
\textsuperscript{281} Denny felt that a 20% debt repayment ratio could be maintained after figuring agricultural imports, but cautioned on the difficulty of holding this 20% line. \textit{Id.}
\textsuperscript{282} Denny & Surls, \textit{supra} note 272, at 18.
\textsuperscript{288} See CHINA NEWSLETTER 10-13 (June 1978), especially Table VII which predicts the PRC's financing needs under the terms of the LTTA. \textit{Id.} at 11.
B. New Financial Arrangements for Purchases Under the LTTA

Japanese efforts to lighten China's debt burden under the LTTA are constrained by the OECD's "gentlemen's agreement" on interest rates for loans extended by government-affiliated financial institutions to the developing world. Although these OECD guidelines are voluntary and are without enforcement procedures, Japanese freedom of action has been severely inhibited by the United States. Washington considers it especially important for Tokyo to observe the OECD limitations because of the size of its foreign trade surplus.

After the signing of the LTTA, Tokyo offered several alternative financial plans to the Chinese. Money could be lent by such government organs as the Overseas Economic Co-operation Fund (OECF) and the Japan Export-Import Bank (Ex-Im Bank) at interest rates below OECD standards. Another approach would permit the Ex-Im Bank to give direct financial assistance to Japanese importers of Chinese goods in the form of advance payments. Under this method, a Japanese importer of crude oil would be provided with funds at a low interest rate, and then turn the money over to the Chinese seller as an advanced payment for the oil to be shipped. Credit would be received by the Chinese seller, since the oil might not be delivered to the buyer for quite some time. A portion of Japan's bulging foreign reserves could be deposited with Chinese banks to be used for import financing. The foreign reserves passed on by the government to individual Japanese institutions for deposit also could be extended to Chinese businesses in the form of purely private credit, and thus could be offered at interest rates below OECD minimums. On ideological grounds, the Chinese, in the summer of 1978, were still reluctant to support the OECD because it was an aid-dispensing

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284 Medium-term loans of a two-to-five year duration made by Western nations to China must carry a 7.25% annual interest rate, since the PRC is regarded as a developing country. If the loan is for six-to-ten years, the interest rate becomes 7.5% with a possibility that the deferral period can stretch up to twelve years for construction of steel plants and electrical power facilities. See id. at 12.


286 OECF loans are available at only a 3.5% to 5.5% yearly interest rate and mature in thirty years with a ten year grace period. The OECD 7.25% rate can be ignored by the OECF, since the latter is in the business of giving out foreign aid, which is not governed by the OECD standards. However, the offers of funds from the Ex-Im Bank with interest rates below 7.25% were in direct opposition to the OECD guidelines, which are applicable to Ex-Im Bank operations.


organization, and Ex-Im Bank funds were equally tainted since acceptance of such monies would denote a government-to-government loan. However, in talks with the British in August 1978, the PRC seemed amenable to private bank-syndicated loans.289

By the Fall of 1978, Chinese moderation in financial matters was in full flower. In the September extension to the LTTA, the PRC accepted the OECD restriction on interest rates, thus capitulating to international economic reality. Moreover, the PRC agreed in principle to receive loans from the Ex-Im Bank. In a proposal proffered by the Japanese in September, the borrowing was to be considered "commercially based," allowing Peking to maintain the illusion that it was not a direct government obligation. Credit would be in the 200 to 400 billion yen range (one to two billion dollars), and would be given to the BOC for oil and coal development, at a 6.25% annual interest rate on a five-to-ten year repayment schedule.290 Japan would not be violating the 7.25% OECD rate because the Ex-Im Bank was ostensibly providing "import financing"—money devoted to the development of Chinese national resources, and not to the paying off of Japanese imported items.291 Troubled by the sharp rise in the yen, Peking rejected the specifics of the plan, and demanded that United States dollars be the medium for borrowing. Responding to Chinese pressure, Tokyo invented a new Resources Development Dollar Fund financed by the Ex-Im Bank. About one billion dollars would be channeled by the Bank to those Japanese companies involved in overseas resource development, e.g., coal mines in China. Interest rates for these loans would be quite reasonable, around 6% for energy-related projects and 6.5% to 7% for other natural resources.292

The Chinese continuing indecision over government-to-government loans was illustrated in October of 1978, when two contradictory statements were made within the course of two weeks. To a distinguished British industrial delegation, Peking intimated that such direct assistance would be acceptable at some future date, while earlier, a mission of the EEC was told flatly that direct governmental loan assistance was still prohibited.293 As for foreign aid, in a fall visit

289 Id., August 25, 1978, at 57-58. Peking had even suggested that the British government should guarantee these private banks from the financial risks involved in a syndicated loan deal in order to make such an arrangement more enticing to bankers.
291 Id.
292 Id., October 13, 1978, at 44.
293 Id., October 27, 1978, at 40, 43.
to the Mainland, Mr. Inayama, one of the chief architects of the LTTA, got the definite impression that the PRC was even contemplating the use of Tokyo's OECF.294

Peking's supposed repugnance towards joint ventures gradually faded in 1978. Witness the discussions with both Japanese and American oil companies for cooperative enterprises in the Pohai Gulf area.295 Unambiguous signals came from the PRC in December 1978, when the Japanese Trade Association was told that joint ventures would be allowed.296 In the set-up envisioned by the Chinese, Japanese companies would be held to a forty-nine percent ownership of the joint venture, with the Chinese participants given the right to buy out the Japanese investors over a ten year period.

In December of 1978, details of the Nippon Steel plant agreement for the mill at Paoshan were released. A remarkable feature of the deal was Peking's readiness to pay in cash.297 This was in line with previous 1978 Chinese financial arrangements concluded with the Japanese. Some Japanese sinologists surmised that Peking's eagerness to spend hard currency could be attributed to a surplus of around two billion dollars in its balance of payment position.298 One Japanese trader predicted that this Chinese practice cannot continue for long, as the Mainland's need for investment funds will be $600 billion in the next few years, and it is unlikely that Chinese exports will provide more than $100 billion.299

Then why is China expending so much of its precious surplus at this stage? It simply could be a matter of timing. All the details of the proposed new financial vehicles for Sino-Japanese trade have not been completely worked out, so in the meantime, cash will be used. For both political and psychological reasons, Peking realizes that the modernization movement must show intangible results immediately, and that interminable negotiations over financial terms have to be avoided. By offering easy financing in the initial period of modernization, China enhances its reputation for fiscal reliability, which would tend to create a bandwagon effect among foreign investors.

294 Id., October 13, 1978, at 45.
295 According to the Japan External Trade Organization, as of November 1, 1978, other tentative joint ventures between Japan and China were planned for the coal mining, electrical power, nuclear power and onshore oil development sectors. CHINA NEWSLETTER 21 (December 1978).
298 Id.
Although China is financially vulnerable, it is not without bargaining power. Complaining about the disturbing rise in the value of the yen, Peking has threatened:

Plant exports from Japan to China are quickly losing their competitive power as to prices, when compared with plants manufactured in Europe. Unless Japan realizes the easing of conditions for the extending of deferred-payment loans . . . it will become difficult to carry out the Japan-China Long-Term Trade Agreement.300

At present, the West is enamored by the idea of trading with China, and as long as this fierce competition among the United States, Japan and the EEC continues, the PRC should be able to attain better financial terms.

XII. SINO-JAPANESE TRADE AND GLOBAL COMPETITION

For both countries the LTTP channel of trade is not indispensable. From the Japanese point of view, although they are the PRC's biggest single customer, the size of the market pales when compared to the product quantities exported by Japan to the United States and Western Europe. Japan's economy is geared to the production of sophisticated technological items on an enormous scale, which at this juncture in its development China can only absorb in limited amounts.

An interesting comparison can be drawn between the volume of Sino-Japanese and Japan-Taiwan trade. While in the 1966 to 1975 period trade with the Mainland exceeded $14.3 billion with Japan earning a $2.4 billion surplus, in the same years Japan had a $5.2 billion favorable balance of trade with Taiwan out of a total volume of $13.5 billion.301 In the following two years the amount of Japanese business transacted with Taipei exceeded the trade done with Peking.302 Even in the first half of 1978, when Sino-Japanese trade recorded an all-time high, Japanese commercial activity with Taiwan surpassed this level by almost $100,000.303 Previous post-normalization period attempts by the

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300 Mainichi Shimbun, April 1, 1978, at 7. Apparently, because of its shortage of foreign exchange funds as well as its decision to lower development goals, Peking abruptly suspended in late February 1979 over two billion dollars worth of contracts for plant equipment with Japanese companies, most notably Nippon Steel Corporation. Kyodo (Tokyo), February 28, 1979; id., March 2, 1979.

301 G. HSIAO, supra note 2, at 64.

302 See FAR EAST. ECON. REV., June 24, 1977, at 61, for the 1976 figures; see FREE CHINA REV., March 1978, at 38, for the 1977 statistics; cf. note 3 supra.

303 STATISTICAL BUREAU, EXECUTIVE YUAN, REPUBLIC OF CHINA, NATIONAL CONDITIONS 16 (1978); cf. note 4 supra.
PRC to dissuade Tokyo from trading so extensively with Taipei have not had a dramatic negative impact on the volume of Japan-Taiwan trade. Especially now, when China is so anxious for Japanese technology, it is unlikely that China will be very concerned about Tokyo's flourishing commerce with Taipei.

On the other hand, Japan will encounter more and more competition from other industrialized nations in the struggle to gain a prominent foothold in the Chinese market. The leadership in Peking will discern the folly of relying too heavily on any single trading partner for most of its imports. No nation has a monopoly on the successful production of advanced technology. With so many eager foreign suitors, China has the enviable opportunity to select only the best plants and equipment and obtain these at reasonable prices. Its bargaining position vis-à-vis Japan was certainly increased by the April 1978 trade agreement concluded with the EEC, which granted the PRC most favored nation treatment and lowered tariff barriers. By 1978, the EEC countries' percentage share of Chinese imports was nearly equal to Japan's, with West Germany and France as the leaders. In the first half of 1978, the amount of EEC exports to the Mainland recorded an astronomical 125.2% jump over the same period in 1977. Very disquieting from the Japanese perspective was that most of this growth came in the heavy industry sector.

In the summer of 1978, Japanese petrochemical firms had lost out in competitive bidding with their West German counterparts on several large China projects. In addition, German and British interests were engaged in the modernization of the PRC's coal mines. The British also were getting involved in the power generation industry and hoping to construct iron and steel plants, and the Dutch were to provide two-to-three billion dollars worth of harbor facilities. Late in 1978, the French made the most significant move by concluding a long-term trade accord with the PRC, valued at $13.6 billion. For the European competitors of Japan, the relaxation of COCOM restrictions will give them a new method of improving the volume of their China trade. In addition, through the sales of defense-related equipment they will probably be able to generate greater non-military business.

Yeh, supra note 20, at 18.
CHINA NEWSLETTER 23 (June 1978).
Id. at 2 (December 1978).
Id. at 7 (September 1978).
See ECONOMIST, October 14, 1978, at 115, for an industry-by-industry review of foreign investment and commercial activity in the PRC during 1978.
Most definitely now, after the recent normalization of relations with the PRC, the United States will become a major competitor with the Japanese in the search for Chinese markets. Even before normalization, American companies were exploring the possibilities of developing the Pohai Gulf offshore oil deposits, Sperry Rand and IBM were selling computer systems to the PRC, Boeing was to deliver 747's to the Mainland, and two hotel chains, the Intercontinental and the Hyatt, were engaged to build new tourist facilities in China.\textsuperscript{310}

In spite of Western competition, Japan's share of the China trade will always be substantial considering its geographical proximity to the Mainland, the intrinsic quality and variety of its industrial goods, and the traditional cultural ties linking the two nations.

XIII. CONCLUSION

Spurred on by the terms of the LTTA, Sino-Japanese commercial relations are entering a new era of unprecedented prosperity and expansion. For the moment, ideological barriers to the modernization impulse are being conveniently ignored in Peking. In the area of corporate financing, the PRC has demonstrated interest in promoting joint ventures in order to more rapidly develop natural resources. To achieve industrialization, exports of manufactured goods will have to be encouraged. A harbinger of things to come could be the use of Shumchun in Canton Province as a testing ground for joint export ventures and as a model export-processing zone.\textsuperscript{311} Acknowledging the role of objective international standards in trade relations, Peking has offered to promulgate new commercial laws protecting foreign investors and especially their patent rights. The year 1978 saw the Mainland basically announce its intentions to be a full fledged member of the international financial community. Although still not irrevocably committed to accepting direct government loans or foreign aid, there are indications suggesting that official Chinese requests for these forms of assistance will come in the near future. The PRC has already contacted the United Nations Development Programme, which is a major force in distributing aid to the developing world.\textsuperscript{312} It will not be surprising to find Peking seeking admission to international financial institutions such as the IMF and the World Bank. Membership in these global bodies would have two important effects—it would be a symbol

\textsuperscript{310} \textit{Id.}
\textsuperscript{311} \textit{FAR EAST. ECON. REV.}, August 18, 1978, at 51.
of China's financial maturity, and Peking would gain access to more sources of easy financing.

China's remarkable desire to learn the virtues of Western capitalism is particularly strong in the economic organization area. Incentive, profit and productivity have all entered the lexicon of Chinese economic thinkers. In order to fulfill the ambitious goals of the Ten Year Plan, the system of economic management must be rationalized and centralized. High productivity is not a result of proper political thought but is dependent on the methods of economic planning currently superior in the West—the proletariat must pay heed to the "bourgeoisie" in a capitalistic country because they "consciously do things according to objective economic law."

It is in this field that the PRC can especially profit from the Japanese experience, since Japan was able to achieve its astonishing metamorphosis in the post-World War II period through the assimilation of Western management techniques.

Prospects for Sino-Japanese trade will be affected by several domestic constraints on China's modernization program. China's transportation network, whether it be railroads or port facilities, is inadequate for the purpose of distributing effectively a staggering influx of imported goods. Doubts have been raised by the Japanese about the quality of China's oil and coal supplies, which are relied on to bring in much needed foreign exchange. It will be no simple task both technically to develop new reserves of energy such as offshore oil deposits or new coal mines. China could be caught in a vicious economic vise—the money spent on modernizing its export industries like oil and coal will be so great that the earnings from these products will not match the development costs.

Though committed to the encouragement of Sino-Japanese trade, JETRO has examined the domestic situation in China with a dispassionate and skeptical eye. As a general rule of thumb, Peking will have to invest domestic funds equal to three times the value of its imports. Such a debt burden will mean the goals of modernization inevitably will clash with the PRC's sense of fiscal conservatism. China will have to reconcile the different aims of the Four Modernizations plan. Internal tensions could be produced by a scramble for scarce resources. With Western powers freed of many COCOM limitations, the Chinese military's appetite for weaponry could become insatiable.

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513 FAR EAST. ECON. REV., October 27, 1978, at 38.
514 CHINA NEWSLETTER 9 (June 1978).
Moreover, the agricultural basis of the economy is still shaky. Bad harvests over the last two years have compelled the PRC to import large quantities of wheat. This chronic inability to feed a rapidly expanding population certainly could siphon off much needed investment from the industrial sector, and further impede China's modernization drive.

To preach technical development as a part of the Four Modernizations plan could also lead to the creation of a "new class" as well as fissures in the social structure.

[Accelerated industrialization through introduction of foreign technology and industrial plants is likely to result in preferential treatment for researchers and engineers directly involved as well as the technocrats involved in promoting the industrial projects, thereby expanding the disparity between the intellectual class and the worker-farmer class, and between industrial cities and farming villages.]

Most fundamentally, there is no assurance that the current leadership will survive to see the Four Modernizations program firmly implanted in China, or that it will not modify the goals of the Four Modernizations campaign when faced with growing internal discontent and opposition.

What conceivably will have the most far-reaching effect on Sino-Japanese trade is the philosophical readjustments already made by the present Chinese government regarding the concept of self-reliance. In the past decades, the PRC's defiant brand of political independence and economic autarchy was immensely appealing to many developing nations. The emphasis on indigenous technology and labor-intensive techniques, the refusal of foreign aid, the focus on self-financing as a way to "de-link" China from reliance on Western nations, and a decentralized system of economic decision-making were all tenets of the

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315 Indications are that the 1978 grain crop was only a 10 million ton improvement over the disappointing 1977 total of 285 million tons. From the United States alone in 1978, China purchased 4.5 million tons of corn and wheat at a cost of more than $500 million. Wash. Post, November 14, 1978, § A, at 18.

316 CHINA NEWSLETTER 9 (June 1978).

traditional PRC notion of self-reliance, which have now been amended or discarded by the Teng-Hua leadership. Self-reliance has proven to be a dynamic principle, ever-changing to meet the new special needs of the Chinese people. China's present course of industrialization and technological improvement may be the decisive turning point away from a no longer operative form of self-reliance. Isolation both culturally and economically is not feasible in a world becoming increasingly interdependent. It is possible that the current Peking regime has accurately assessed the mood of the Chinese nation, and that its bold experiment with modernization, while amendable, will not be reversible.