

CRS Report for Congress

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China and the World Trade Organization

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Summary

China has sought over the past several years to become a member of the World Trade Organization (WTO), the international agency that administers multilateral trade rules. China's WTO membership (as well as that of Taiwan's) was formally approved at the WTO Ministerial Conference in Doha, Qatar in November 2001. On December 11, 2001, China officially became a WTO member. WTO membership will require China to significantly liberalize its trade and investment regimes, which could produce significant new commercial opportunities for U.S. businesses. A main concern for Congress is to ensure that China fully complies with its WTO commitments. This report will be updated as events warrant.

After 15 years of bilateral and multilateral negotiations, China formally entered the WTO on December 11, 2001. The negotiations on China's accession to the WTO focused on many Chinese practices that distort flows of trade to and from China, such as high tariffs and non-tariff barriers, restrictions on foreign investment, lack of national treatment for foreign firms, inadequate protection of intellectual property rights (IPR), and trade-distorting government subsidies. Membership in the WTO will require China to change many laws, institutions, and policies to bring them into conformity with international trade rules.

The WTO Accession Process

The rules for joining the WTO are stated in the Agreement Establishing the WTO, which was signed on April 15, 1995, as part of the Final Act implementing the results of the Uruguay Round of multilateral trade negotiations. The Agreement provides that any state or separate customs territory may accede to the WTO on terms to be agreed between it and the WTO. It further provides that decisions on accession shall be taken by the Ministerial Conference (the highest authority in the WTO), which shall approve an agreement on the terms of accession by two-thirds majority.¹

¹ While WTO decisions on important matters such as accessions formally require a two-thirds majority, in practice, the WTO has relied on consensus to reach important decisions.

Negotiations over the terms of accession typically proceed on two fronts — multilateral consultations in a Working Party composed of all interested WTO members and bilateral negotiations between the applicant and each major trading partner. The Working Party focuses on the general rules and principles of the applicant's protocol: it seeks to ensure that the applicant will accept the normal obligations and responsibilities of WTO membership and sets schedules for complying with various WTO agreements. The bilateral meetings, on the other hand, focus on tariff concessions and other market access issues that will govern bilateral trade relations after the applicant becomes a member, and will apply on an MFN basis to all other WTO members. An applicant becomes a member by persuading first the Working Party and then the full WTO to approve an accession package, which consists of a protocol that lists the commitments undertaken by the applicant concerning WTO rules, a Working Party report elaborating on those commitments, and a schedule of bilateral market access commitments for trade in goods and services. Chinese officials negotiated to develop such a package with the Working Party in Geneva and with 37 WTO members that requested bilateral trade deals.

China's Interest in WTO Membership

China made its accession to the WTO a major priority for a number of reasons. First, it would represent international recognition of China's growing economic power. Second, it would enable China to play a major role in the development of new international rules on trade in the WTO. Third, it would give China access to the dispute resolution process in the WTO, reducing the threat of unilaterally imposed restrictions on Chinese exports. Fourth, it would make it easier for reformers in China to push for liberalization policies if they could argue that such steps are necessary to fulfill China's international obligations. Finally, Chinese leaders hoped WTO membership would induce the United States to grant China permanent normal trade relations (PNTR), or most-favored-nation (MFN), status, thus ending the annual trade status renewal process and subsequent congressional debate over U.S.-China relations.

The Role and Interest of the United States

The United States played a central role in China's WTO accession process. U.S. trade officials insisted that China's entry into the WTO had to be based on "commercially meaningful terms" that would require China to significantly reduce trade and investment barriers within a relatively short period of time. For many U.S. firms, China remains a difficult market to penetrate, due mainly to Chinese government policies designed to protect and promote domestic industries.² These policies attempt to encourage imports of products that are deemed beneficial to China's economic development, such as high technology, and machinery and raw materials used by export-oriented industries. Goods and services not considered to be of high priority, or which compete directly with domestic Chinese firms, often face an extensive array of trade barriers. Such barriers often force foreign firms to invest in China in order to gain market access, although they face a variety of restrictions in doing so as well. U.S. officials blame such policies for the surging U.S. trade deficit with China which reached nearly \$84 billion in 2000.

² U.S. exports to China in 2000 were \$16.3 billion (a 23.9% increase over 1999 levels), making China the 11th largest U.S. export market.

Many U.S. trade analysts viewed China's WTO accession process as an opportunity for gaining substantially greater access to China's market. China has been one of the world's fastest growing economies over the past several years (real GDP growth averaged 9.5% annually from 1979 to 2000), and many trade analysts argue that China could become a potentially large market for a wide variety of U.S. goods and services if greater market access were afforded. Accession to the WTO would require China to lower its trade barriers, afford "national treatment" to foreign firms, make its trade laws more transparent, and subject its trade regime to review by the WTO dispute resolution process. Other U.S. proponents of China's WTO membership contended that it will advance the cause of human rights in China by enhancing the rule of law there for business activities, diminishing the central government's control over the economy, and promoting the expansion of the private sector in China.

The November 1999 U.S.-China WTO Agreement

U.S. and Chinese officials reached a bilateral agreement relating to China's WTO bid on November 15, 1999.³ The agreement would commit China to reduce tariffs and remove non-tariff barriers (some upon accession and others over specified phase-in periods). The full text of the agreement was released by the Clinton Administration on March 14, 2000. Some of the major commitments China agreed to include the following:

- Provide full trading and distribution rights (including the ability to provide services auxiliary to distribution) for U.S. firms in China.
- Cut average tariffs on agricultural products from an overall average of 22% to 17.5%; tariffs for U.S. priority agricultural products (such as beef, grapes, wine, cheese, poultry, and pork) would fall from 31% to 14%. Overall industrial tariffs would fall from an average of 24.6% to 9.4%; tariffs on U.S. priority industrial products would fall to 7.1%. Tariffs on information technology products would be fall from an average of 13.3% to zero.
- Establish a tariff-rate quota system for imports of agricultural bulk commodities (such as wheat, corn, cotton, barley, and rice), i.e., imports up to a specified quota level would be assessed a low tariff (1-3%), while imports above a certain level would be assessed a much higher tariff rate. In addition, private trade in agricultural products would be permitted for the first time.
- Phase out quotas and other quantitative restrictions (some upon accession, many within two years).
- Eliminate unscientifically based sanitary and phytosanitary restrictions on agricultural products, end export subsidies, and reduce domestic subsidies.
- Open service sectors, including distribution, insurance, value-added telecommunications, banking, securities, and professional services. China would expand (over various transitional periods) the scope of allowed services and gradually remove geographical restrictions on foreign service providers. The amount of permitted foreign ownership in service

³ These measures were included in the final WTO China accession agreement.

industries would vary (and in some cases expand over time) from sector to sector.

- Reduce restrictions on auto trade. Tariffs on autos would fall from 80-100% to 25% (tariffs on auto parts reduced to an average rate of 10%) by 2006. Auto quotas would be eliminated by 2005. U.S. financial firms would be allowed to provide financing for the purchase of cars in China.
- Remove various restrictions on foreign investors in China, including technology transfer, local content, and export performance requirements.
- Accept the use by the United States of certain safeguard, countervailing, and antidumping provisions to respond to possible import surges of various products from China, such as textiles, that might cause, or threaten to cause, market disruption to a U.S. industry.

China Joins the WTO

China completed all of its WTO bilateral agreements on September 13, 2001, when it reached a trade agreement with Mexico, the last of the 37 WTO members that had requested an agreement. China completed negotiations with the WTO Working Party on September 17, 2001 on the terms of its accession.⁴ China's WTO membership was formally approved by the WTO on November 10, 2001, and on November 11, China informed the WTO that it had ratified the WTO agreements. As a result, China officially joined the WTO on December 11, 2001.

China's entry into the WTO has important implications for the world trading system. By some estimates, China is the world's third largest economy, after the United States and Japan, and the world's 10th largest trading economy. A World Bank report estimates that China's share of world trade could triple from 3.0% in 1992 to 9.8% by the year 2020, making China the world's second-largest trading nation after the United States.⁵ The growing importance of China in the world economy was an important factor in the heightened interest among WTO members in bringing China into the WTO and thereby subjecting its trade regime to multilateral trade rules. China's WTO application was particularly difficult because, in many respects, China is still a developing country, and yet, its economy and trade are significant. Many WTO members, including the United States, argued that China needed to make substantial reforms to its trade regime in order to join the WTO, while China insisted it be treated as a developing country, which would have enabled it to implement reforms over a longer period of time. In the end, a compromise agreement was reached that requires China to make immediate and extensive reductions in various trade and investment barriers, but allows it to maintain some level of protection (or a transitional period of protection) for certain sensitive sectors.

The Role of Congress

Congress did not play a direct role in the WTO accession process. That is, current U.S. law did not require congressional approval of the November 1999 U.S.-China WTO

⁴ The WTO Working Party handling Taiwan's accession formally rapped up its negotiations on September 18, 2001.

⁵ The World Bank, *China 2020: China Engaged*, 1997, p. 31.

trade agreement, nor was it needed for the United States to support China's admission to the WTO. However, in order to ensure that the WTO agreements would apply between the United States and China, Congress passed H.R. 4444 (P.L. 106-286), granting the President authority to extend permanent normal trade relations (PNTR) status to China upon its accession to the WTO.⁶ The bill also established a special Congressional-Executive commission to monitor and report on various aspects of China's policies on human rights (including labor practices and religious freedom) and ordered the U.S. Trade Representative (USTR) to annually issue a report assessing China's compliance with its WTO trade obligations. On December 27, 2001, President Bush issued a proclamation granting PNTR status to China effective January 1, 2002.

Implications for U.S.-China Commercial Relations

China's accession to the WTO, and the U.S. extension of PNTR status to China, will likely have important ramifications for U.S.-China economic relations. First, Congress will no longer vote annually on China's trade status, which could help bring greater stability and predictability to the trade relationship. Second, the United States (as well as China) will be able to use the WTO dispute resolution process to resolve trade disputes, rather than relying on unilateral threats of trade sanctions. Third, subjecting China's trade regime to multilateral rules means that the United States will no longer have to "go it alone" in trying to get China to open its markets; other WTO members would have an equally strong stake in ensuring China's compliance with its WTO commitments. Finally, China's accession to the WTO will likely improve the business climate in China, leading to greater trade and investment opportunities for U.S. firms. A sizable increase in U.S. exports to China would help reduce tensions over trade issues.

However, many analysts have raised concern over the ability and willingness of the Chinese government to fully implement its WTO commitments. Based on U.S. experience with past trade agreements with China, there are likely to be many disagreements as to whether certain new Chinese laws and regulations bring China's trade regime into compliance with WTO norms, as well as over how the new laws and regulations are actually carried out and enforced.⁷ Several WTO-related disputes have already arisen. For example, in June 2001, China announced it would soon implement new rules on bio-engineered foods, but did not provide details of these rules (which made U.S. exporters nervous that their soybeans would not be let into China) and also reportedly tightened its inspection and quarantine procedures; this led to a disruption in U.S. soybean exports to China. President Bush raised this issue with Chinese President Jiang Zemin in October 2001, which led China to agree to the interim use of U.S. and foreign certificates until China implements its new biotechnology regulations (which later could become a point of

⁶ Prior U.S. law required China's NTR status to be renewed on an annual basis (which it was from 1980 to 2001); a measure considered inconsistent with WTO rules if applied to a WTO member. Without a change in law, the United States would have been forced to invoke Article XIII in the WTO, the non-application clause, towards China.

⁷ For example, under a January 1992 IPR agreement with the United States, China pledged to pass new laws to protect IPR. However, the United States later charged that, while China had passed new IPR laws, it failed to enforce them. Similarly, under an October 1992 market access agreement, China pledged to reduce or eliminate a number of tariff and non-tariff barriers. However, in some cases, China eliminated one trade barrier only to replace it with another.

contention if the United States holds that such regulations are unreasonable and violate WTO rules).⁸ Another dispute occurred in November 2001, when the Chinese government reportedly developed new licensing rules on tariff rate quotas on certain agricultural products that the U.S. charged were discriminatory and violated WTO rules.⁹

Corruption and local protectionism are rampant in China, and gaining the cooperation of local officials and government bureaucrats that oversee various affected industries to implement WTO-consistent rules could prove difficult in the short run. Additionally, economic reforms required under WTO commitments could lead to significant short-term employment disruptions in China, especially among farmers and employees of inefficient state-owned enterprises. Some analysts warn that such disruptions might erode the government's determination to fully implement its WTO commitments, especially if it fears social stability is threatened.

WTO Issues of Concern to U.S. Firms

U.S. firms that export to, or invest in, China are deeply interested in ensuring that China complies with its WTO commitments to remove discriminatory trade and investment restrictions and practices. Their concerns focus largely on development and implementation of China's plans to bring its trade regime in compliance with WTO rules. U.S. firms want to make sure that reforms are made as soon as possible and are enforced uniformly at the central, regional, and local government levels. They also want to be able to review proposed rules, laws, and standards and to have access to Chinese lawmakers and regulators in order to submit proposed changes (within a reasonable time period) before they go into effect. They want to ensure that texts of all new laws, regulations, and standards are made publically available, and that all such changes are written in a manner that is clear, consistent, and imposes no unreasonable burdens to U.S. firms. And finally, they want to ensure that the spirit of China's WTO accession agreement is achieved, so that the removal of trade and investment barriers specified under the WTO agreement actually leads to new trade and investment opportunities and is not undermined by the issuance of new restrictive rules, standards, or policies that in effect replace one barrier with another.

Congress will likely press the Bush Administration to ensure China's trade compliance with its WTO commitments. The required annual report by the USTR on China's WTO implementation (due one year after China's WTO entry) could become the focal point of potential Congressional concerns over China's compliance. If U.S. exports fail to increase significantly, and the USTR's report finds serious deficiencies with China's compliance, Congress may press the Administration to file numerous dispute resolution cases against China in the WTO.

⁸ Some analysts have charged that China is deliberating attempting to limit soybean imports in order to protect domestic producers.

⁹ According to *Inside U.S. Trade*, China intended to create two separate licenses for tariff rate quota levels (i.e., the quantity of imports that would be subject to low tariffs) on certain agricultural products. One type of licence would be issued to end-users and the other to processors. The United States charged this practice was discriminatory and would limit agricultural imports.