China joins the WTO: How, Why and What Now?

The process has been complex and far from smooth. The overall long-term effects should be positive, but don't expect too much, too soon.

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Abstract:
This article analyzes the process and probable effects of China's entry into the WTO from several different angles. The prospect of China's membership has been controversial, both within China and in the international community, slowing the process considerably. A key factor pushing China's application forward has been China's significant move toward a market-oriented economy in the 1990s. However, adapting to the negotiated WTO package will be only part of the major changes China is likely to experience in the coming decade.

This article benefited from information and insights gained during five months of research, teaching and travel in China in 2000.

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The story of how China joined the WTO is, on one level, a simple one. The advanced nations, led by the United States, let China in once they felt that China's economy had reformed sufficiently to meet WTO requirements. On another level, the technicalities of the bilateral and multilateral negotiations were by no means simple. China was too advanced in some sectors for WTO member countries to be comfortable giving developing country status that brings with it loose timetables and "differential and more favorable treatment" for meeting WTO obligations.[1] But China was also not a developed economy by most measures, as its delegation endlessly pointed out. Hence every aspect of China's entry has been carefully negotiated, adding to the time it has taken for China's application to be completed. In the end, the full protocol was thousands of lines of tariffs and specific agreements covering approximately 1500 pages (O'Neil 2001).[2]

Another piece of the story is that certain leaders in China championed this cause unflaggingly. In particular, key members of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) believed strongly in China formally re-joining the international economy. Premier Zhu Rongji, who has a reputation as a reformer, was a key supporter and probably the main reason the issue was kept alive. The Republic of China had been an initial member of GATT when it was formed in 1948, but then resigned in 1950 in the aftermath of the civil war and move to Taiwan (Tucker 2000). China applied to regain its seat in 1986. The final chapter was not written until November 11, 2001, when the trade ministers gave formal approval for China's membership at their annual meeting, with Taiwan's approval following a day later.

Somewhat unexpectedly, the terrorist attacks on the U.S. in September 2001 led to a flurry of negotiations and compromises that cleared the final hurdles for China's membership. President Jiang Zeming, in his call to President Bush immediately after September 11th, reportedly asked that this issue among others not be lost in the events that would follow the attacks. The tenacity of China's leaders' push towards joining WTO over a decade and a half is remarkable in the light of difficult transition challenges and serious opposition at home.

Why China Wanted to Join

Faced with the complexities of joining WTO, and the fact that joining meant China's laws, trade policies, and domestic regulation of doing business would have to change dramatically, why would China's leaders place such importance on this step? Part of the answer can be found in the dynamics between reforms in China, world events, and policy decisions made by WTO member countries, in particular the United States.

While China is not a democratic or particularly open society, people have competing interests that shape what happens there. Difficult to see from the outside sometimes, Beijing does not represent all of China, MOFTEC does not represent all central ministries, and Zhu Rongji does not represent all of the central leadership. Debates, uncertainty and foot-dragging within China about the benefits of changing to fit the norms of international capitalism are additional reasons why the process of joining took so long. Once a consensus was reached at the highest levels of leadership in early 1999, however, formal debate over the wisdom of joining was forbidden. Prohibiting debate angered academics, journalists, and others who understand the importance of airing different views, but it did not end the opposition.

The roots of opposition are tied to the very beginnings of reform. In 1978, China had no foreign investment and very little trade. Contrast that with the present, where China has been the largest recipient of direct foreign investment in the developing world since 1992, and is among the top ten trading countries in the world.[3] Although the reforms that opened China to international markets were gradual, by the mid-1990s foreign invested enterprises began to gain serious market share. Coca Cola and Pepsi had basically taken over the entire soft drink market in China, and the presence of others like Procter & Gamble and Volkswagen was ubiquitous with products and advertising. In addition, multinationals looked invincible and overpowering. Some popular examples were that Microsoft's capitalization was one and a half times the size of both the Shanghai and Shenzhen stock exchange put together, and Wal-Mart's annual sales represented 40 percent of China's total sales revenue (Wang, 2000, pp.60, 62).

Two sides of the debate emerged at this time.[4] One side argued that China was relying too much on foreign investment and that development of the domestic, national economy should be the priority. The other side argued that in fact China still had too little foreign investment, and that more liberalization was required to insure progress. The Asia crisis in 1997 gave the national economy advocates the upper hand. By 1998 it looked as if China would stop pushing so hard for WTO membership, and focus on APEC and other regional organizations instead (Hai, 1998).

A year later everything changed. Zhu Rongji arrived in Washington in April, 1999, with a surprisingly concessionary package designed to pave the way for a U.S.

blessing on China's membership. We still do not have a full understanding of the internal bargaining that allowed for such a serious renewed push to join WTO. However, there are a number of factors, both economic and political, that probably played a role in tipping the scales back toward membership.[5]

The most widely cited reason for China's push to join is that supporters of liberalization saw it as a way to keep the process of reform going. For example, numerous plans have been initiated to restructure and revitalize state-owned enterprises since the mid-1980s, but only minor progress has been made. With the opening of many sectors to foreign competition, it is expected that numerous state companies will either have to rise to the occasion and compete successfully or close. The state sector is supported by the banking system, which carries a high burden of non-performing loans. Serious banking reform is therefore necessary to avoid a major crisis. The experience of the Asian crisis brought this point home for many in China, and created a sense of urgency. With WTO membership, foreign companies and banks would increase their presence in the Chinese market, setting examples and creating competition for the domestic system.

A second factor may have been a result of watching the high-tech revolution of the 1990s. Chinese leaders want China to be part of these developments, and there may be increasing awareness that this would be much easier if China was seen as a credible partner in the international economic system, which would include protection of intellectual property. WTO membership is also expected to attract more foreign investment, some of which would bring desired new technology or help enhance China's own capabilities for technological development. The fact that China joined the

Information Technology Agreement, which phases out all tariffs on information technology products by 2005, gives credence to this as one factor supporting membership.

A third factor concerns exports. China's exports have increased substantially throughout the reform period, helping China earn foreign exchange for needed imports and spurring growth via demand. Continued increases, however, are problematic. The willingness of countries to open their markets even more to Chinese goods is being tested by political resistance to what is seen as unfair trade in terms of China's willingness to reciprocate. This problem would be greatly reduced within the WTO framework, because China will then be seen as part of the fair trade system. In addition, quotas blocking more Chinese imports will be phased out as part of the terms of China's membership. Both of these changes will help increase China's exports.

The fourth factor is political. Once China joined WTO it would no longer be hostage to annual Congressional reviews in the U.S., where all kinds of grievances were raised as possible reasons to deny China Most Favored Nation status. Further, once a member, Chinese negotiators would have some influence in making the rules of international trade and therefore be able to weigh in on the issues that concern them. They also would have more credibility and clout to deal with their own grievances on dumping and other trading issues. Finally, China wanted to make sure that Taiwan did not join first so that China would have a say in that economy's status in the organization.

The Final Steps

Despite the combination of factors that caused China to make its offer to the U.S. in April 1999, the process continued to be less than smooth. President Clinton, for domestic political reasons, rejected Zhu Rongji's offer. In May, the U.S. bombed the Chinese Embassy in Belgrade, upsetting relations and all negotiations. Once negotiations resumed, after many meetings and seemingly little progress, the U.S. and China finally completed their bilateral agreement on November 15th, 1999.[6] After much debate within the U.S. Congress, the House voted 237 to 27 in favor of granting China Permanent Normal Trading Rights (PNTR) May 24th, 2000, followed by the Senate's favorable vote of 83 to 15 on September 19th. Although the PNTR vote was not required for China's WTO membership, it meant that the U.S. would be in compliance with WTO rules when China joined and therefore the U.S. economy would enjoy the benefits of the negotiated package.

The U.S. bilateral agreement opened the way for the European Union to complete its agreement, which virtually assured that China would join. However, numerous issues continued to stall the process. At the end of 2000, even the bilateral negotiations were not yet finished, with Mexico being one of the last. Then in April 2001, a U.S. spy plane collided with a Chinese plane, causing renewed tensions and delaying progress. By then, as well, there was speculation that even some in China were having second thoughts. At the National People's Congress in March, Premier Zhu was quoted as acknowledging frankly that adjusting to WTO would be difficult, implying that having more time would be desirable (Kazer 2001).

Table 1: China and Taiwan Join the WTO: Major Milestones

1947	Republic of China is one of the original members of the General Agreement on Trade & Tariffs (GATT)
1949	People's Republic of China is established on the mainland and Republic of China moves to Taiwan
1950	Republic of China resigns from GATT; People's Republic of China denounces GATT for ideological reasons
1986	People's Republic of China applies to renew membership in GATT; Hong Kong joins as a customs territory
1990	Taiwan applies to join as a customs territory
1992	Taiwan gains observer status and informal agreement is reached that Taiwan would join after China
1995	GATT is replaced by the World Trade Organization (WTO)
15 November 1999	U.S. & China announce bilateral agreement
19 May 2000	European Union & China finish agreement
24 May 2000	U.S. House of Representatives vote 237 to 27 in favor of granting China Permanent Normal Trading Rights (PNTR)
19 September 2000	U.S. Senate vote 83 to 15 in favor of PNTR
10 September 2001	Required by U.S. law, President Bush certifies the U.S.-China bilateral WTO agreement
14 September 2001	WTO members finish agreement for China to join
11 November 2001	WTO ministers formally accept China as a member, followed by Taiwan the next day
11 December 2001	The People's Republic of China officially becomes the 143rd member of WTO
1 January 2002	Taiwan as "Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (TPKM)" officially becomes the 144th member of WTO

Over the summer the process continued to stall over several issues. The American insurance company, AIG, had been allowed to operate in China with wholly owned subsidiaries since 1994. The new WTO rules, however, stated that foreign invested insurance companies must have at least 50 percent Chinese ownership. European companies, along with Chinese negotiators, did not want to make an exception for AIG, but AIG was already operating under the original agreement and would have to seek out partners retroactively. Further, China wanted to use price controls in agriculture to help cushion the transition, after they had agreed they would phase them out.

The final stages of the process was pushed forward by the terrorist attack on the U.S. on September 11th. Most likely due to a high-level decision in the U.S., all sides agreed to disagree on the AIG issue, and let it be resolved within the WTO framework once China was a member, and the agricultural price control issue ended in a compromise (Kahn 2001).[7] On September 17, China was cleared to join, with formal approval conferred on November 11th at the annual meeting of trade ministers in Doha, Qatar. China became the 143rd member on December 11, 2001, with Taiwan becoming the 144th member on January 1, 2002. A fifteen-year quest had been completed.

The Impact on China

The possible impact on China of joining WTO has been the subject of much speculation. Given all of the changes China is facing with or without WTO, it may well be difficult to sort out the effect of WTO per se. Some of China's own analysts have estimated that about 10 million jobs will be lost in farming, autos, aluminum, petrochemicals, and steel, and about 10 million jobs will be gained in services, textiles, garments, and non-farm rural activities in the first five years. International trade is expected to nearly double, and there is great hope for a surge in foreign investment. Increases in efficiency are expected to increase average gross domestic product 1 percent per year or less, largely from resource reallocation more compatible with comparative advantage combined with increased exports and technological investment.[8] These estimates seem to be reasonable and they do not indicate major upheaval or fantastic paybacks.

The bigger story lies in how joining could change the nature of the debate and policy choices within China. WTO establishes a structure where a rules-based trade policy is required, backed by a legally binding contract between governments and a government-to-government dispute settlement process. Being part of this structure will make a significant and lasting difference in at least two ways: it will challenge China's past economic policy principles, and it will alter the distribution of fortunes of particular interest groups within China.

In the past, economic planning supported a national development strategy in China. The importance of planning has declined since reforms began in the early 1980s, but much of the planning mentality and some of the tools continue today. For example, policies of targeted import control, low-cost loan access, trading rights, and even pricing have been used to promote production in selected sectors. Each new five-year plan targeted technologies and industries within an overall logic of the development process. To speed up the acquisition of desired technologies in the 1990s, domestic market access was allowed to sweeten many bargains with foreign firms. To support industry, and for self-defense reasons, the principle of self-sufficiency in grain has been a foundation of China's agricultural strategy for decades. Also underlying China's opening to global markets was the principle of maintaining balanced trade, backed up with a fixed exchange rate and the ability to limit imports when necessary.

None of these principles are valid under China's negotiated WTO agreement. The policy debate and tools will have to move from planning for favored industries to maintaining macroeconomic stability by indirect market means. What we should see is a move towards more global and regional specialization and an output mix driven by consumer demand. Markets, not planners, will determine whether China will have a trade deficit or a trade surplus, and there will be pressures to eventually let the exchange rate float as well.

Change in China since reforms began in the late 1970s has been consistent with more marketization and fewer government directives. In this sense joining WTO is just the next step in China's transition. But there is a difference. China has made an agreement with most countries of the world to give up an important set of policy tools in order to be a full member of the international community. Member countries will be watching for compliance, and China will be using the international agreement to achieve domestic change.

Overall the long-term benefits should be positive for China, but in the transition stage there will be serious costs, especially in terms of short-run employment. Further, those who will gain from the agreement are a completely different set of interests than those who benefited from the old strategy. The winners include consumers, exporters, and the private sector; the losers include many state-owned enterprises, the banking and insurance sectors, and farmers. The legitimacy of the Chinese government will depend on how China's leaders handle this transition while staying within the boundaries of WTO compliance.

Table 2: WTO Redistributes Benefits

Winners	Losers
The private sector	Many state-owned companies
Consumers	Banking
Exporters	Insurance
Transport: containers	Telecommunications
Services: household and professional	Automobiles
Textiles and apparel	Heavy industry, e.g. steel, aluminum
Light manufactures, e.g. electronics, toys	Farmers; e.g., grain, soybeans & cotton
Non-farm activities in rural areas	State trading companies

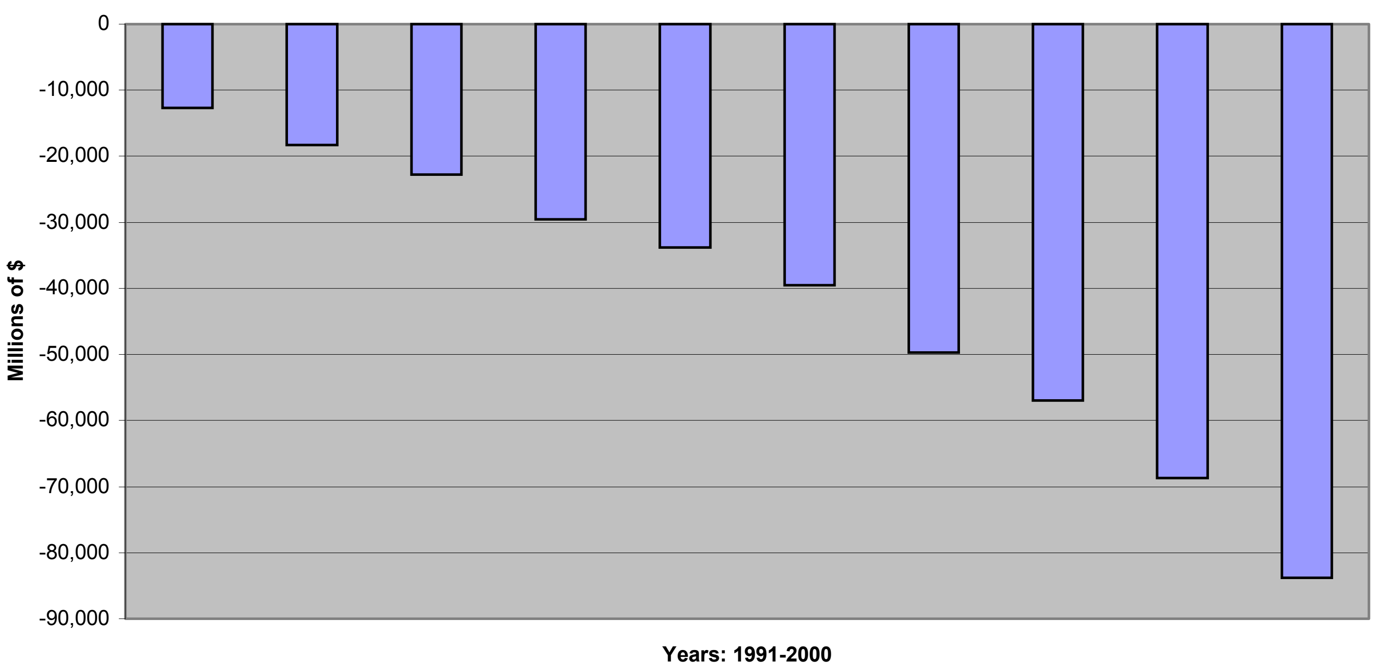
Reasonable Expectations

China's participation in WTO is a major milestone for both China and the international community. It is not a panacea, however, and its benefits have been exaggerated, perhaps dangerously so. Some commentaries in the U.S. have suggested, for example, that China's participation in WTO will bring about liberal political change. WTO is an economic agreement about trade. It does not address, nor should we expect it to affect, political constraints or human rights conditions. To make too much of this important agreement is to invite a backlash against it if things do not go as well as people hope.

Even in the economic realm, expectations are unrealistic. Some in the U.S. are counting on WTO to reduce the large trade deficit we have with China by expanding U.S. exports to China. This bilateral deficit has grown from $13 billion in 1991 to $84 billion in 2000.[9]

Growth in U.S. exports to China, however, may not depend primarily on WTO. The most important determinant of our exports to China will be how fast China's economy grows. An analysis by Mark Frazier (1999) at the National Bureau of Research shows that U.S. exports to China have grown approximately 15 percent per year between 1990 and 1998—a period with very high overall growth in China averaging nearly 10 percent. More recently, China's growth has slowed and is expected to be about 7 percent per year, if all goes well. It is likely growth will be even slower than 7 percent as the country makes difficult adjustments and deals with a global slowdown.   Hence, the growth of U.S. exports to China would also slow, even as WTO agreements kick in. This would no doubt catch the attention of business and political leaders here.

Figure 1
U.S. Trade Deficit with China (China's Surplus with the U.S.)



While the future overall effect on U.S. exports is uncertain, the U.S. economy will gain due to increased transparency and predictability about the rules of doing business with China. Furthermore, certain sectors such as agriculture, industrial products, insurance and financial services will be especially helped by the agreement. In agriculture, the average tariff rate on key U.S. products will fall from 31 percent to 14 percent, which could generate an additional $2 billion a year in agricultural exports. Items in this category include beef, poultry, cheese, oranges, apples, wine and grapes. Cotton exports should also be helped by a large reduction in tariff-rate quotas. In the industrial sector, autos, auto parts, wood and paper products, and high tech products such as telecommunications equipment and semiconductors will benefit from a variety of lower import barriers. In insurance, reinsurance is now completely open, non-life insurance can be wholly foreign owned within two years, and life insurance allows 50 percent foreign ownership. All geographic limitations will be phased out within three years. In banking, there will be full market access within five years. Partial foreign ownership in telecommunication companies will also be permitted, with geographical restrictions phased out over time.[10]

Although China should also benefit from joining, a backlash in China is possible. China's challenges are immense. The road forward is going to be very difficult under the best of circumstances, which would be the case with or without WTO membership. Many state-owned enterprises must lay-off large portions of their work force and some will close. The banking system has far too many branches and employees. Agriculture is so inefficient in terms of labor-land ratios that farmers are having trouble making a living. Estimates vary, but perhaps as many as 140 million people are underemployed, and 16-18 million are outright unemployed in urban areas. The macroeconomic effect of joining WTO is expected to be a wash in terms of employment, but the resulting restructuring will add to many people's existing worries in a very visible way.

China's economic nationalists opposed to China's entry into WTO could seize on these problems to bolster their argument that joining puts China at risk of exploitation and vulnerability to international markets. Adding economic pressure at a difficult time, China's exports have been hurt in the current global recession since the terrorist attacks on September 11th. WTO could be construed as a tangible reason for China's troubles. If WTO is blamed, inevitably this blame will be transferred onto the U.S., hurting U.S.-China relations.

Another focal point in U.S.-China relations is Taiwan. There is no doubt that the economies of China and Taiwan will become much more integrated as a result of both becoming WTO members. Taiwan is in the midst of major restructuring to lower manufacturing costs, which is largely being achieved by moving offshore. The destination of choice has been the mainland, even before the WTO agreements. The question is how this increasing interdependency will affect China's treatment of Taiwan, and whether it will strengthen or weaken the political support in Taiwan for accepting a status subordinate to China's central government in Beijing as required by Beijing's "one country, two systems" formula. China could try to resolve trade issues through internal negotiations as it does with Hong Kong. This would lessen the benefits of joining for Taiwan, as it would not be treated as a separate entity. Or, China could use the structure of WTO to further relations with Taiwan, including the possibility of establishing direct trade links. It is in the U.S. interest for China and Taiwan to work together peacefully towards resolving their differences. The WTO provides an important international framework, agreed to by both sides, for that to happen.

Going Forward: Implementation

Now that the treaties have been signed, the next step is to implement the agreements. In China, both the central and local governments are addressing this enormous task. Fundamental aspects of implementation are already in place, such as meeting transparency requirements and lowering tariff rates. Day to day implementation, however, will require making sure local laws are in compliance and enforced, training custom officials, and the like. Shanghai, for example, has set up a WTO Affairs Consultation Center to provide information and training, and to demonstrate that Shanghai will be in compliance. Universities, think tanks, and government agencies in China have published a variety of books on WTO, and distributed them widely across China. These books address the hopes and concerns of the general population, and the tasks of the officials that will have to implement the changes. Despite these efforts, this phase of increasing awareness and carrying out implementation will not be easy or quick.

Outside of China, surveillance of the progress of implementation is also taking shape. As part of the WTO agreement, a Transitional Review Mechanism was set up as a forum for members to bring concerns to China's attention. In the U.S. government, the Department of Agriculture has set up a China Task Force to monitor progress, and the International Trade Administration has a five point Compliance Plan to be monitored via the Trade Compliance Center under the Market Access and Compliance Division of the U.S. Commerce Department.[11] In addition, there are monthly meetings of the Trade Policy Staff Committee, chaired by the U.S. Trade Representative Office, for U.S. Government agencies who want to follow China's progress.[12]

Nonetheless, despite compliance oversight and a wholehearted effort on China's part to play by the rules, more, rather than less, conflict between foreign businesses and the Chinese bureaucracy is likely. In addition to hundreds of laws that need to be re-written, the rules of doing business are in flux. While most of these changes are for the good, confusion will increase in the short-term. Patience, and realistic expectations, will help. The important point is that China has joined the international global economy in a major, and probably irreversible, way.

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Notes:

[1] The Enabling Clause, Pat IV of the GATT agreement.

[2] The full WTO protocol provided by the Chinese government can be found in English and Chinese at www.moftec.gov.cn/moftec_cn/wto/wtolaw.html.

[3] World Bank, < www.worldbank.org/data/datequery.html > (22 February 2002), and World Development Indicators CD-ROM 1998.

[4] A version of this debate is presented in Wang (2000).

[5] For one Chinese scholar's perspective, see Wang (1999).

[6] A summary of the U.S.-China Bilateral WTO Agreement, as well as a link to specific agreements by industry, can be found at the U.S.-China Business Council website at <http://www.uschina.org/public/wto>.

[7] Annex 4 of the Protocol lists all of the products that will retain "state pricing" or "government guidance pricing" for some time. The agricultural products listed include tobacco, certain grains, vegetable oil, and cotton.

[8] The Development Research Center of the State Council has done a series of estimates. See references to this work in *The China Business Review*, "The Impact of WTO Accession on China," Jan.-Feb.2000, pp.40, 42. The Development Research Center has also published a book of its results (Li, et al, 2000). See also, Jun Ma (2001) for another set of estimates.

[9]U.S. Department of Commerce, International Trade Administration, <http://www.ita.doc.gov/td/industry/otea/usfth/tabcon.html> (23 March 2001 and 12 October 2001), Table 8. Note that these figures are based on the U.S. methodology, which show a larger bilateral deficit than the Chinese figures largely due to the treatment of trade flows through Hong Kong.

[10] <www.uschina.org/public/wto/ustr/generalfacts.html< (2 March 2001).

[11] As part of this effort the Department of Commerce has set up a website to inform U.S. businesses on China's obligations and compliance at www.export.gov/china.

[12]< http://usinfo.state.gov/regional/ea/ushchina> (7 February 2002).