

# 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. In September 2001, China completed its multilateral negotiations with the WTO Working Party handling its accession application and reached a trade agreement with Mexico, the last of the original 37 WTO members that requested a bilateral trade agreement with China. 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. China is expected to join the WTO on December 11, 2001. WTO accession commits China to significantly reducing a wide variety of tariff and non-tariff barriers. Legislation (H.R. 4444) granting China permanent normal trade relations (PNTR) status (once it joins the WTO) was enacted into law on October 10, 2000 (P.L. 106-286). A main concern for Congress is to ensure that China fully complies with its WTO commitments once it accedes. This report will be updated as events warrant.

To accede to the WTO, China must change many laws, institutions, and policies to bring them into conformity with international trade rules. The negotiations on China's accession to the WTO have 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, and trade-distorting government subsidies.

### 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.<sup>1</sup>

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 have been trying to develop such a package with the Working Party in Geneva and with its trading partners.

## **China's Interest in WTO Membership**

China has 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. Fifth, China has sought WTO membership as a means to obtain permanent normal trade relations (PNTR), or most-favored-nation (MFN), status from the United States; currently, that status is renewed annually. Finally, China wants to participate in the next round of multilateral trade negotiations in the WTO.

## **The Role and Interest of the United States**

The United States has played a central role in China's WTO accession process. U.S. trade officials have insisted that China's entry into the WTO must 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.<sup>2</sup> These policies attempt to encourage imports of products that are deemed beneficial to China's economic

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<sup>1</sup> 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.

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

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.

Many U.S. trade analysts view China's WTO accession process as an opportunity for gaining substantially greater access to China's markets. 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, provided that greater market access was afforded. China's WTO accession would require it 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 observers contend that WTO membership would 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. Finally, China's WTO accession would likely result in Taiwan's accession; China has insisted that Taiwan can gain membership to the WTO only after China enters.

## **Implications for the World Trading System of China's Application**

China's application to the WTO has important implications for the world trading system. China is currently the largest economy that is not a member of the WTO. By some estimates, it is the world's third largest economy, after the United States and Japan, and the world's 10<sup>th</sup> 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.<sup>3</sup> The growing importance of China in the world economy has heightened interest in subjecting China's trade regime to multilateral trade rules. China's WTO application has been 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, have argued that China should make substantial reform to its trade regime in order to join the WTO, while China has insisted it be treated as a developing country, which would enable it to implement reforms over a longer period of time.

## **The U.S.-China WTO Agreement**

U.S. and Chinese officials reached a bilateral agreement relating to China's WTO bid on November 15, 1999.<sup>4</sup> The agreement would commit China to reduce tariffs and

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<sup>3</sup> The World Bank, *China 2020: China Engaged*, 1997, p. 31.

<sup>4</sup> The conclusion of the U.S.-China WTO trade agreement was an important breakthrough in China's 15-year effort to join the WTO, due in part to the important role the United States plays in the WTO

remove non-tariff barriers (some on accession and others over specified phase-in periods). The full text of the agreement was released by the Clinton Administration on March 14, 2000.<sup>5</sup> Some of the major commitments China has 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 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.

## **Status of China's WTO Bid**

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

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<sup>5</sup> The full text of the agreement can be found at [<http://www.uschina.org>].

September 17, 2001 on the terms of its accession.<sup>6</sup> 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 will officially join the WTO on December 11, 2001.

## The Role of Congress

Congress does not play a direct role in the WTO accession process. That is, current U.S. law does not require congressional approval of the November 1999 U.S.-China WTO trade agreement, nor is it needed for the United States to support China's admission to the WTO. However, most trade analysts have argued that, in order to ensure that the United States would gain the full benefits of China's WTO accession, the U.S. would need to extend PNTR treatment to China prior to its accession.<sup>7</sup> According to this view, without such a change in law, the United States would be forced to invoke Article XIII in the WTO, the non-application clause.<sup>8</sup>

## Congressional Action On PNTR

During its negotiations with China over the terms of its WTO accession, the Clinton Administration pledged that, in return for significant market opening commitments on the part of China, it would press Congress to enact PNTR legislation. Once the November 1999 U.S.-China agreement was reached, the Clinton Administration began to push for passage of PNTR legislation.

On May 15, 2000, Representative Bill Archer introduced H.R. 4444, a bill to grant PNTR status to China upon its accession to the WTO (as long as the President certified that the final terms of China's accession were at least equivalent to the November 1999 U.S.-China trade agreement). Several provisions were added by the House to H.R. 4444 in response to various congressional concerns. In addition to the provisions contained in the original version of H.R. 4444, the final bill, which passed in the House on May 24, 2000, the Senate on September 19, 2000, and was signed into law on October 10, 2000 (P.L. 106-286), would:

- establish 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;

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<sup>6</sup> The WTO Working Party handling Taiwan's accession formally rapped up its negotiations on September 18, 2001.

<sup>7</sup> Under the Jackson-Vanik Amendment (Section 402) to the Trade Act of 1974 (19 U.S.C. 2432), freedom-of-emigration requirements, the United States can and does (on an annual basis) extend normal trade relations (NTR) treatment to China.

<sup>8</sup> Article XIII can be invoked by either a current WTO member or an acceding WTO member if either member does not consent to the application of WTO agreements to each other (such as the granting of "unconditional" MFN status). Analysts believe that the current renewal of China's NTR status is not consistent with WTO rules, and hence the U.S. would have to invoke Article XIII to avoid violating WTO rules. If the United States (or China) invoked Article XIII, the WTO agreements technically would not apply between the United States and China, and thus China could choose not to apply the WTO agreements to U.S. firms and investors.

- require the U.S. Trade Representative (USTR) to annually issue a report assessing China's compliance with its WTO trade obligations;
- codify the anti-surge mechanism established under the November 1999 U.S.-China trade agreement and establishes procedures for obtaining relief from import surges;
- expand funding for various U.S. government agencies to monitor China's compliance with its WTO trade commitments; and
- set up a special government task force to halt U.S. imports from China of products suspected of using prison labor.

## Implications for U.S.-China Commercial Relations

China's accession to the WTO, and a U.S. extension of PNTR status to China, could have important ramifications for U.S.-China economic relations. First, Congress would no longer vote annually on China's trade status, which could help bring greater stability and predictability to the trade relationship.<sup>9</sup> Second, the United States (as well as China) would be able to use 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 would 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 would 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 once it obtains membership. Corruption and local protectionism are rampant in China, and gaining the cooperation of local officials and government bureaucrats that oversee various affected industries could prove difficult in the short run. In addition, economic reforms required under WTO commitments could lead to significant short-term employment disruptions, 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. Congress will likely press the next 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 dispute resolution cases against China in the WTO.

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<sup>9</sup> However, because China did not gain WTO accession by June 3, 2001, President Bush had to issue a waiver (under the Jackson-Vanik amendment) in order to extend China's NTR status for an additional year. Legislation (H.J.Res. 50) to disapprove that waiver was defeated in the House on July 19, 2001.