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November 2001

Online at <https://mpra.ub.uni-muenchen.de/93536/>

MPRA Paper No. 93536, posted 01 May 2019 16:39 UTC

# China's Accession to the WTO

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## Summary

*After fifteen years of unsuccessful attempts, China, whose foreign trade accounts for 7% of world trade, has just returned to the World Trade Organization (WTO). The concessions it has made affect all of its economic sectors. While the impact of membership is likely to have long-term positive effects, the short-term adjustment cost may be high for the Chinese economy and society. Politically, however, entry into the WTO can accelerate the reforms undertaken in the country, and there is every reason to believe that China no longer has any interest in going back.*

It is now fifteen years since the People's Republic of China was a candidate for GATT membership (General Agreement on Tariffs and Trade) and then the WTO. This request has now been successful, obtaining formal validation at the Doha summit. During these fifteen years, the world has undergone considerable changes, both in political systems and in the international trading system. The length of the process is commensurate with the stakes of this membership.

The links between the world and Beijing have intensified: the annual amount of foreign direct investment (FDI) in China has increased tenfold between the beginning and the end of the 1990s. China's foreign trade volume quadrupled between 1987 and 1998, reaching \$322.7 billion. In 2000, it accounted for 7% of world trade (compared with 2% in 1980), accounting for more than half of US foreign trade and more than Japan. The economic stakes of membership are therefore far from negligible, and two questions deserve to be asked: in what sense will membership weigh on Chinese and world economies? And what adjustment costs will China face in the short term?

Deng Xiaoping's economic reforms were openness to the world. What will be the impact of membership on Chinese domestic politics? Does China want or can it really implement its commitments? What is the effective scope of the agreements?

In 1948, nationalist China was one of the founding members of the GATT; but it withdrew as early as 1950, after the birth of the People's Republic of China. From 1986, in the wake of the reforms launched by Deng Xiaoping, China sought to rejoin the organisation, but to no avail. The process slowed down for many reasons: Tiananmen Square events, Western fear of massive imports, human rights issues, intellectual property. It was also a time of mutual incomprehension, both Westerners on the functioning of the Chinese economy, and the Chinese on the implications of GATT clauses.

In April 1995, the WTO replaced the GATT, and Beijing joined the following month as an observer. The formalities for membership must begin with individual negotiations with each of the trading partners. In April 1999, negotiations with the United States failed, but then resumed and led to the signing of an agreement on November 15, 1999 which made permanent the application of the most favoured nation clause to China, a normal situation between WTO member countries. Beijing hoped then to be able to ratify the general protocol and access the organisation before the departure of President Clinton in early 2001. This could not be achieved, especially because there were points of importance to be resolved.

Before June 2001, the agricultural question, linked to the status of a developing country, had not yet been solved. The United States, like China, is particularly sensitive to it. Today, the latter grants subsidies to its 900 million farmers, for a value of up to 2% of production. Fearing massive imports, which could cause 1.6 million farmers to lose their jobs every year for five years, Beijing wants to maintain or increase these subsidies. However, they will be capped at 5% if China accedes to the WTO as a developed country (which the United States wants to help their agricultural exports) or to 10% as a developing country.

On June 9, 2001, the United States and China reached a general agreement that included this issue, but its content was not made public. However, it has filtered out that Chinese subsidies to farmers would ultimately be limited to 8.5% of the value produced. Subsequently, on 20 June 2001, a secret agreement also settled most of the outstanding issues with the European Union. This involved, in particular, the opening up of services, with the licensing of telecommunications, insurance and banking operators.

Of China's 37 partners seeking bilateral negotiations, Mexico was the last to conclude them. It wanted in particular to have access to the Chinese market for certain products (avocados, fish, sugar). Negotiations between these two countries ended on September 14, 2001.

The China-WTO Working Group met again to resolve remaining issues (foreign ownership level in insurance and tariff quotas). It finally approved on September 17, 2001, an 800-page technical document and recommended to the members to agree to China's application for membership of the WTO. It was the same for Taiwan the next day.

The vote of WTO member countries was held in Doha, Qatar on 9 November. The Chinese People's Assembly must now ratify the document, and then it will take 30 days to make the membership binding. It is therefore possible that China is actually a member of the WTO at the beginning of 2002.

The concessions granted by the countries already members are relatively limited (which does not mean that the consequences of China's entry will be). The Americans will thus abandon their quota system on Chinese textiles (the Multifibre Agreement), while maintaining these provisions a few years beyond 2005, when these quotas will no longer be in force for other countries. The United States does not do much more than perpetuate what has been granted annually since 1980.

On the other hand, on the Chinese side, concessions are important. First and foremost, Beijing will have to respect the basic principles of the WTO: most-favoured-nation clause, identical treatment for domestic and foreign products, price-based measures, the end of unfair practices (like dumping). This

regime marks the end of the selective opening strategy. Beijing will also include specific agreements on trade-related intellectual property rights (TRIPs), liberalisation of services (GATS) and trade-related investment policies (TRIMs). In addition, China will have to resort to a multilateral settlement of conflicts, where the bilateral balance of power will have less weight. Finally, it will have to notify its policy changes, especially in the commercial field, and make public the rules it enacts in this area. Beijing has only five years left to carry out fundamental reforms, which is quite short in view of the economic changes.

Finally, it should be noted that China today (before accession) is not a country particularly inaccessible to trade, when compared to other WTO members. While its tariff barriers (before accession) are four times larger than those of Japan, its non-tariff barriers are, once quantified, are eight times lower.

Few economists have risked quantifying the impact of China's WTO accession in terms of growth. Ma Jun and Wang Zhi, who did so, projected an additional 0.1 point for five years on the growth rate of gross domestic product (GDP) of the United States, the European Union and Japan. The impact on trade has been the subject of several studies, most of which focus on the United States. Analysts predict an increase in China's exports to the United States in the order of 7% (in 1999, they accounted for \$41.9 billion, or 21.5% of total Chinese exports). US imports into China could increase by 12%<sup>8</sup> (to a value of \$19.5 billion, or 11.8% of total imports into China). These numbers gave rise to a debate in the United States. In pushing the model, pessimistic experts have worried about the widening of the country's trade deficit *vis-à-vis* China (about \$43 billion in 1998). One of them has even suggested that it will be fifty years before the end of the steady increase in this deficit.

Uncertainty also weighs on the impact of imports on employment in some sectors. According to some estimates, the elimination of US quotas on textiles and clothing could endanger the jobs of 700,000 people. However, this pessimistic picture must be nuanced. In addition, the increase in China's market share may be at the expense of other countries, more than the United States itself. Indeed, it is the economies that produce similar goods, but in a less competitive way, that are likely to suffer the most. In the case of textiles, one can mention Thailand and Malaysia but also Mexico. In the long term, Japan could also be in competition, as Chinese production will evolve in the direction of greater added value.

In the long run, most analyses converge to predict a largely positive impact on the Chinese economy. The annual amount of FDI is expected to double to \$100 billion in 2005. Over time, total trade could rise from \$324 billion (1998) to \$600 billion (2005). Analysts estimate that GDP will increase as a result of accession by 0.5-1% in the short term, and by 1.53 or 4.1% in the medium term. Consumption could increase by 2.1%.

In the game of world trade, China will have to take advantage of its comparative advantages. Economic growth will likely involve reallocating resources to labour-intensive sectors, to the detriment of capital-intensive or technology-intensive production. The long-term winning sectors are likely to be textiles and clothing (which will find markets abroad as they accounted for 20% of exports in 1999), food products (which will benefit from the fall in the price of raw materials), and the production of electrical and

electronic equipment. Likely to losers include some protected sectors, especially the agricultural sector. As for consumers, they will benefit from a much better choice of goods and services than today.

Reallocations of resources in this new competitive environment will not be without difficulty: accession will be accompanied by a short-term adjustment cost, mainly for state-owned enterprises and for certain categories of workers. The process, both economic and social, will follow a 'J' curve effect in deterioration of the situation, then improvement. Thus, the Minister of Trade himself stressed that the challenge was important for state-owned enterprises, which now account for 26% of production. They will face simultaneous competition from foreign firms and domestic non-state enterprises (collective and individual). A natural selection process will eliminate lame ducks and force survivors to discipline and restructure. Chinese economist Hu Angang predicts the closure of one-third of these state-owned enterprises. It will be up to the state to take over its important social role in Chinese society.

Unemployment in China is unofficially about some thirty million people, to which must be added about 100 million migrant workers. Analysts' estimates of the increase in the number of unemployed brought about by accession are extremely variable: they could be 20, 40 or even 50 million, coming from the agricultural sector and state-owned enterprises. The government is convinced that job creation in services and in private industrial SMEs (some of which are foreign-owned) will make it possible to reduce this surplus of unemployed people, and even to reduce unemployment in general. It will still be necessary to train the individuals concerned in their new profession. Chinese officials are also working to set up a social security system (unemployment compensation, reimbursement of health expenses, pensions).

A pessimistic scenario is however still possible. It would be based on massive imports of foreign products and volatile foreign investments. The bankruptcy of the most fragile domestic firms could exacerbate the banking problem of bad debts; unemployment would rise, consumption would fall, and social unrest would emerge. A deflationary spiral would set in, leading to the devaluation of the currency. To avoid the pessimistic scenario, it is a question of managing the short-term adjustment costs by rising the slope of the 'J' curve through liberalisation. Care must also be taken not to increase the gap between those who benefit from openness and the rest of the population, who do not clearly benefit from change. Redistributions will therefore have to be made between regions and generations. The economic stakes appear huge for China, both in terms of opportunities for the distant future, and costs for the near future.

As President Clinton pointed out at the time of the debate on 'permanent and normal trade relations' (PNTR), it is necessary to integrate the new Chinese power into a global decision-making structure like the WTO. China, often distant to foreign countries, will then be subject to binding supranational rules. Adherence to an economic and political system based on a market economy and democratic principles can bring greater security to the Asia-Pacific region and the world at large. In summary, outside it is uncontrollable, inside it would be more easily influenced. For Supachai Panitchpakdi, future Director General of the WTO, China will become a new counterweight to the United States, a bridge between developed and developing countries.

In a simplistic way, the Chinese political world is divided between a rather reformist camp and a rather conservative and nationalist one. For the moment, it is the first that is at the forefront (transition to the market economy, opening to FDI), to the detriment of the second. The WTO is a factor of internal rivalry, and permanently rejecting China's progress could reinforce the nationalist camp. Already, in April 1999, we had an idea of the possible backlash. When Zhu Rongji returned empty-handed from the United States, he was accused of selling the country cheaply, and even described as a 'traitor'. Later, the bombing of the Chinese embassy in Belgrade by the United States, further weakened the position of the reformers. Finally, the Chinese firmness in the episode of the spy plane, in April 2001, confirmed the idea that China was not ready to join. The reform camp therefore took risks, considering the important concessions granted by Beijing. Successful membership of the WTO will favor co-ops, at the expense of a bureaucratic entrenchment and local potentates that benefit from the current system of favouritism and protections.

There are many reasons for Beijing to join the WTO. First of all, to symbolically restore national respectability abroad, and to acquire a definitive status that no longer obliges China to undergo each year the annual American review of the most-favoured-nation clause. However, the challenge seems even more significant domestically. Membership in the WTO can indeed accelerate the reforms undertaken in the country. Thus, when Zhu Rongji came to power in 1998, he focused mainly on the reform of state enterprises. He then understood that the external constraint of the WTO could help him: 'The competition engendered by such a situation will make it possible to promote a faster and healthier development of the national economy'.

Some observers are worried and think that Beijing will give up its commitments if the situation becomes unfavourable. Faced with short-term difficulties, especially unemployment, is the government unlikely to back down under the pressure of the Conservative camp? It is true that the statements of Chief Negotiator Long Yongtu are double-edged. On the one hand, he claims that China will behave like a respectful member of the rules. On the other hand, he suggests that it could change its position based on its appreciation of costs and benefits: 'It's good for China itself. And if it's good for China, we'll stick to it or anything that's against the interests of our country, we just will not do it'. Here one finds the usual ambiguity of a country divided between flexible cooperation and the defense of national sovereignty.

Many elements can encourage trust. For the moment, China is a relatively good student at the IMF and the World Bank. A recent study on Beijing's compliance with its current obligations (environment, intellectual property rights) has shown a mixed record, but much better than its critics think. Moreover, the Chinese government knows that a pullback could scare away the foreign investments needed by the Chinese economy. Most of the work has already been done. China has accepted the highest demands ever placed on a country by entering the WTO. And President Jiang Zemin insisted on the need not to go backward from the rest of the world: 'Economic globalisation is an objective trend of global economic development, which no one can escape and everyone must participate in'. All the more so as it can serve as a driving force for internal reforms.

Beijing has also started reviewing all its regulations and launched an information campaign on the WTO to the people. But it is also necessary that the authority over the provinces be strengthened so that local failures do not lead the government to legal quarrels with trading partners.

Finally, will WTO membership reinforce the existing power structure in China? By their actions, the leaders, seem to think so. Failure could lead to the Conservative clan taking over power. The best way to stay is therefore to continue to raise the standard of living of the inhabitants and to continue the kind of compact concluded between the current political elite and the population: 'You keep us in power, we give you prosperity'.

In conclusion, there seems to be a consensus relative to the positive impacts that long-term WTO membership will have on China and its member countries. The debate is more about short-term adjustments. Entry into the WTO will have a considerable cost in the social field, but perhaps also political. Nevertheless, these costs are inevitable for a China that wants to open and develop and Beijing is now just imposing a timetable that can be a powerful tool for managing reforms. The coming years will be marked by sustained efforts by Chinese leaders not to fall into the pessimistic scenario of a membership that fails due to a poorly controlled transition. Their stay in power depends on it. The Chinese government is therefore challenged to manage the pace of reforms, to make the necessary redistributions and to improve the qualification of its workforce. Finally, economic reforms are likely to cause political change, but the time scale remains unclear. It will be particularly interesting to see how officials will face the pressures that will emerge on the basis of the gap between economic openness and political rigidity.

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