



Trade and the Transformation of China

The Case for Normal Trade Relations

Executive Summary

Congress will soon consider whether to revoke normal trade relations (NTR) with China and then, possibly in the fall, whether to make NTR permanent as part of China's anticipated entry into the World Trade Organization. The consequences of congressional action are huge.

China today is America's no. 4 trading partner. In 1998 Americans imported \$71 billion worth of goods from China and exported \$14 billion, making China the 13th largest market abroad for U.S. goods. Trade and economic reform have helped to lift 200 million Chinese out of poverty since 1978. Revoking China's NTR status would raise average tariff rates on Chinese goods entering the United States from 4 percent to more than 40 percent, putting a chill on U.S.-Chinese commercial relations.

Trade encourages human rights and facilitates the work of Western religious ministries active in China. East Gates International, headed by Ned Graham, son of evangelist Billy Graham, has been

able to distribute 2.5 million Bibles legally in China since 1992. According to Graham, the organization can communicate freely with its contacts in China because of the proliferation of information-exchange technology such as e-mail, faxes, and cellular telephones—a development made possible by trade and economic reform.

Making China's NTR status permanent before its entry into the WTO would allow American companies to reap the benefits of the "breathhtaking" offer made by Chinese premier Zhu Rongji in April to open up China's economy to international competition.

Finally, China's entry into the WTO would encourage further economic reform in China and restore its faltering economic growth. To facilitate that entry, the United States should drop its unreasonable demands that China agree to an extension of U.S. quotas on textile imports and stricter antidumping and "safeguard" rules that discriminate against Chinese exports.

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Preface

This Trade Briefing Paper is based on an edited transcript of the June 15, 1999, Policy Forum, "China in the Balance: The Case for Normal Trade Relations," hosted by the Cato Institute's Center for Trade Policy Studies. The panel discussion was held in the F. A. Hayek Auditorium at the Cato Institute in Washington, D.C. Speaking at the forum were Ned Graham, son of evangelist Billy Graham and president of East Gates International, a Washington-state-based Christian organization active in China; Robert Kapp, president of the U.S.-China Business Council in Washington, D.C.; and Nicholas Lardy, a senior fellow in the Foreign Policy Studies Program at the Brookings Institution and author of the 1998 book, *China's Unfinished Economic Revolution*. The forum was moderated by Dan Griswold, associate director of the Cato Center for Trade Policy Studies.

Introduction

by Dan Griswold

America's large and growing trade relationship with China has reached a crossroads. The decisions made in the next few weeks and months by Congress, the administration, and the Chinese leadership in Beijing will have a profound impact on U.S.-Chinese relations for years to come.

In early June President Clinton issued a waiver granting China a one-year exemption from the Jackson-Vanik amendment to the Trade Act of 1974. The waiver allows goods made in China to enter the United States under the same normal tariff rates applied to goods from all but a handful of foreign nations. By law, Congress can reject the waiver by passing a resolution by the end of the summer denying normal trade relations (NTR) status to China. Congress is expected to vote on just such a resolution before the August recess.

The consequences of this decision are huge. China is today America's no. 4 trading partner,

ahead of Germany and Great Britain and behind only Canada, Mexico, and Japan. Last year American consumers and companies bought \$71 billion in goods made by the people of China. Those goods range from toys and shoes to computers and computer components. If you have kids in your house, you know that it is just about impossible to visit a mall or a discount store without buying something with the Made in China label.

For American producers, the people of China represent the 13th largest export market in the world and one of the fastest growing. American companies own billions of dollars of productive assets in China.

If NTR with China were to be revoked, the average tariff rate on imports from China would vault from about 4 percent to more than 40 percent. The biggest losers would not be the Chinese leadership but millions of typical Americans who would be forced to pay more for everyday consumer items. They are the main beneficiaries of our expanding trade with China, and they would be the first casualties if NTR were severed.

Other losers would be American companies that are now or hope to be doing business with the people of China. Revoking NTR would put America's economic relations with China in a deep freeze, inviting trade retaliation, depriving the Chinese of American dollars with which to buy our exports, ceding the Chinese market to non-American companies, and reducing the value of American-owned assets in China.

The other major class of victims would be the people of China, especially those in the growing urban middle class who have benefited the most so far from China's economic opening to the world. Revoking NTR would cripple the cause of economic reform in China. It would reduce the real wages of Chinese workers and deprive Chinese families of the economic tools they need to build better lives and increase their economic independence from the government.

Free trade and economic reform have been a godsend to China's poor. According to the World Bank, the number of Chinese living in

what it terms absolute poverty—that is, on less than \$1 per day—has fallen since 1978 by 200 million. Repealing China’s NTR status would set back one of the most successful poverty reduction programs in the history of mankind.

Disrupting trade would deliver an equally heavy if less quantifiable blow to human rights and political reform. The same reforms that have opened the door to goods, services, and investment have also opened doors to tourists, academics, missionaries, and, just as important, ideas. Today 2 million Chinese are on the Internet, and that number is growing exponentially. The works of F. A. Hayek are now being legally published and distributed in China.

Despite this progress, China remains an authoritarian regime; its government denies citizens many basic rights. But China is not the same place it was 20 years ago, when government control was totalitarian and the population was still traumatized by the mass terror of the Mao years.

In the long run, economic liberalization and rising incomes tend to promote a more open political and social order. In South Korea and Taiwan, decades of economic growth spurred by economic reform and trade liberalization have helped to nurture Western-style civil liberties and representative government. Even in Singapore, which is supposed to be an example of a political system immune to the softening effects of economic liberalization, this tendency is beginning to show. According to a June 2 front-page story in the *Wall Street Journal*, the government in Singapore has been easing controls on political and social life because policymakers there have discovered that controls have stifled creativity and risk taking in the economy, placing domestic firms at a disadvantage in the global economy.

Civil and political liberties are good for business, and vice versa. That is a lesson we should not ignore in the debate about our trade relations with China.

Each of these considerations assumes even greater weight this year as China readies itself for entry into the WTO. Before the United States can enjoy the full benefits of Chinese membership in the WTO, Congress must

grant a permanent waiver of Jackson-Vanik, extending to China the same unqualified, nondiscriminatory treatment we have agreed to give other members of the WTO.

Our panel will examine America’s commercial relations with China from three distinct perspectives. Ned Graham is president of East Gates International, one of the major Christian missions active inside China today. Robert Kapp is president of the U.S.-China Business Council, the leading trade group for U.S. multinational companies engaged in business in the People’s Republic of China. Nicholas Lardy of the Brookings Institution is one of the nation’s leading experts on Chinese economic reform.

Engagement Opens Opportunities for Christian Service

by Ned Graham

I would like to explain what the organization I lead, East Gates International, is and is not.

First, East Gates International is a religious nonprofit corporation whose primary purpose is to have a positive impact on China’s religious history. We have sought to accomplish this through developing relationships at all levels of Chinese society and through engaging those responsible for establishing and implementing religious policy. We have sought to help the leadership of China better understand that spiritual values are not Western or imperialistic but core to being human and that religious practitioners who live by spiritual values can only serve to help and strengthen society.

Because of this engagement, we have been able to legally distribute over 2.5 million Bibles to nonregistered religious practitioners since 1992. We have also been involved in publishing and distributing biographical, historical, and cultural religious literature such as Martin Luther’s *Here I Stand*. We are currently in negotiations to publish my father’s memoirs, *Just As I Am*. In addition to publishing and dis-

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tributing literature, we are involved in religious training programs in both the registered and unregistered religious communities.

Second, even though we are extensively involved in the People's Republic of China and I myself have traveled there more than 40 times, we are not experts on China. China is a huge and complex country with a long and involved history. Even the most knowledgeable people I know, including Chinese leaders themselves, have a difficult time truly understanding China as a whole. For myself, the more I learn about China, the less I realize I truly know.

Third, we are not political. We do not endorse candidates nor do we take political positions.

Fourth, while we advocate free trade and engagement with the PRC and are therefore aligned with many businesses that work in China, we receive no funding or benefits from any for-profit corporations or businesses. We are funded exclusively through the support of individuals and nonprofit foundations.

A Revolution in Information Exchange

That being said, I would like to address the question, "Have Western religious organizations working in the PRC benefited from the expanding commercial ties between the United States and China?"

The answer, as my son would say, is a "no-brainer." Yes, of course. Because of China's opening the gates of trade to the West and the economic reforms initiated by Deng Xiaoping, we have witnessed one of the most remarkable changes in history.

When we first started traveling extensively to China in 1990, less than a year after the Tiananmen Square incident, Western missionary activity was almost completely underground. The only notable "open" involvement was the World Council of Churches, which had established diplomatic ties of sorts with the Three-Self Patriotic Movement and the United Bible Societies, which had funded the Bible printing press in Nanjing known as Amity. There was also a handful of organiza-

tions sending English teachers and low-level technicians who could not be involved in overt religious activities such as preaching, teaching, or proselytizing.

Now there are perhaps hundreds of different mission groups either working or attempting to work openly in China. They are involved in education, service-sector training and retraining programs, publishing, other media, humanitarian assistance, medical and dental work, animal husbandry, agriculture, and many other creative endeavors.

Ten years ago there was almost no information-exchange technology available to the average Chinese citizen. If we wanted to contact a friend in China, we usually had to do so by mail unless that individual had a private phone, which was extremely rare especially in the inland provinces. Also, no one outside large corporations or government offices had access to computers, modems, faxes, or cell phones, and even usage of those technologies was tightly controlled and monitored. Up until a few years ago, hotels routinely monitored phone lines for digital tones and then cut connections if they were discovered. (I have spent a night or two in hotels trying to explain to Public Security Bureau officials why I should be allowed to send and receive e-mails from my room.)

In the past, people could not travel freely, choose where to live, have a say in what type of education they received, pursue a career of their choice, or start a business.

Today, despite difficulties, much of that has changed. We routinely communicate with thousands of friends all over China via fax, cell phones, and e-mail. The proliferation of information-exchange technology has allowed us to be much more effective in developing and organizing our work in the PRC.

Along with economic reforms, over the past 10 years we have witnessed a dramatic increase in personal freedoms for the Chinese. Now our friends in China can travel anywhere they wish by whatever means they can afford. They can choose a career or start a business and even place their children in private schools.

Trade and the Rule of Law

This sea change within China has been of great benefit to organizations such as East Gates, whose main work involves negotiations and dialogue with Chinese at all levels of society. But it is important to note that even though East Gates is a religious organization, we confront many of the same challenges that businesses face while working in China, such as leviathan bureaucracy; nepotism; the use of poorly defined laws, policies, and regulations to obtain competitive advantages or outright control; bribery; and opaque decisionmaking processes. The list goes on.

We have been in an ongoing struggle to get our business partners in China, especially in publishing, to become more transparent and to conform to internationally accepted standards of business practice. Over the years, as our relationships have deepened, we have seen improvements in this area, but there still needs to be greater consistency in how business is conducted in China from city to city and province to province. This is also true for the implementation of religious policy.

We believe expanding U.S. economic ties with China and especially China's admittance to the WTO will continue to benefit religious organizations working in China by (1) encouraging China's adherence to international law and a rules-based trading system, (2) facilitating development of the rule of law by China's civil society, and (3) expanding personal freedoms for the population.

China's WTO admittance, however, should not be granted *carte blanche*. Personally, I would like to see us encourage China to fully define and publish all policies, laws, and rules governing religion. From the governmental level, all the way down to the township level, China should also be urged to publish and clarify all internal directives concerning article 36 of its constitution. China should also clarify (by written rule) exactly how it expects all officials (the Religious Affairs Bureau, the Public Security Bureau, and local village officials) to interpret and implement those religious policies. It would also be helpful if there were either a set penalty for officials who violated religious

policies or a procedure for forcing their accountability and providing redress for individuals whose rights are violated.

I believe that accession of China to the WTO will only encourage China's continued involvement with the global village, increase the availability of information-exchange technology, create greater progress in the development of the rule of law, and allow for increased contact between U.S. and Chinese citizens. This will certainly benefit Western organizations seeking to assist the religious population in China.

"High-Decibel" China Bashing

I would like to comment briefly on the propensity of some leaders in the U.S. religious community to naïvely and publicly criticize China—often without first-hand knowledge and on the basis of unverified or exaggerated reports.

When China sees religious leaders in the West using their religion as a political platform, engaging in "high-decibel" China bashing, it only reinforces China's perception that most religions are Western and imperialistic and reinforces hard-liner belief that organized religion is actually a cover for insidious political activity. The misperceptions on both sides only serve to stress the relationship between the United States and China and ultimately harm religious practitioners in China and the Western organizations that seek to serve them.

U.S. trade and the engagement of non-governmental organizations with China bring about greater understanding through the personal relationships that develop as a natural consequence of that type of activity. The development of those kinds of interpersonal relationships is essential to bringing about understanding at the state level. The futures of the United States and China are intertwined, and this relationship will perhaps be the most important throughout the coming century.

Personal Freedoms Have Increased "Exponentially"

The following remarks were made in response to a question from the audience about the current state of religious and civil liberties in China.

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The kinds of commitments that appear to have been made in the April 8 “Market Access” document are really quite breathtaking.

China has changed dramatically over the 20 years since its market-opening reforms began. Personal freedoms for individuals at all levels of society have increased exponentially.

Persecution has been a part of China’s history. There is no doubt about it. And it hasn’t been just religious practitioners who have suffered persecution. During the Mao years intellectuals suffered much more than religious practitioners did. All levels of society suffered. Today the population-control policies are still in place and are still followed, most of the time voluntarily. As income is expanding and you have double-parent incomes increasing, you find most people are voluntarily putting off having children or limiting themselves to one child. There are still, nevertheless, cases of women taken off the street and encouraged or forced to have abortions.

These things do take place periodically, but they are not as prevalent as some people would have you believe. People will exaggerate stories and cases to make a point. They also tell a lot of stories that happened back in the Cultural Revolution or shortly thereafter and make it sound like they happened yesterday. That’s a very popular technique.

Freedoms for the average individual, in terms of expression of faith, are almost no different than here in the United States. If individuals simply are practicing their faith, they have the freedom to do so. They have the freedom to meet where they want. They are encouraged to register with the Religious Affairs Bureau, which is a government organ, rather than with the Three-Self Patriotic Movement, the Catholic Patriotic Association, or the Taoist or Buddhist or Islamic groups. They can actually register directly with the government and thereby be more independent.

I have not, in my experience, encountered individuals who have been recently detained or interrogated or persecuted simply for their faith structure or their beliefs. However, I have encountered people who experienced detainment and worse when they wrapped religion around politics, pro-democracy activity, and independence activity, as in the case of the Muslims in northwest China.

China’s Trade Offer Too Good to Refuse

by Robert Kapp

One of the documents available on the U.S.-China Business Council Web site is the 17-page paper issued by the U.S. Trade Representative on April 8, known as “Market Access and Protocol Commitments.” The United States unilaterally released it to the public on the day that we didn’t quite close the World Trade Organization deal with China during Premier Zhu Rongji’s visit in early April. It represents what our negotiators believe to have been a series of commitments made by China on the way, ultimately, to a signed U.S.-China bilateral WTO accession package. This document is of absolutely seminal importance, and I very strongly urge that you download it from our Web site (www.uschina.org) or the USTR Web site (www.ustr.gov).

The fact that this document was released unilaterally did not make the Chinese negotiators happy; this is not something normally acceptable in bilateral WTO accession negotiations. But I have to say that at the end of the day, I think it was probably a good idea to make it known what we, at least, felt was already committed to by the Chinese. It is true that it seems to have led to significant criticism of Premier Zhu Rongji by some within the Chinese economic, social, and political structure when he returned to China because, as you can tell by glancing at the paper, the kinds of commitments that appear to have been made in this document are really quite breathtaking. In some cases it is said that the final offers that were made by the Chinese were determined even after they had reached the shores of the United States, and went beyond things that had been discussed through the bureaucracy at home. We know that in our own society we have protectionists in business sectors and bureaucratic agencies as well, and that any trade policy is always the result of the pulling and tugging of different forces with different ideas and different interests within society.

China in this sense presents a similar picture.

On the other hand, I think the release of this document caused some extraordinary things to happen. For one thing, this list of supposed commitments really defines, even though it is not as detailed as any final, agreed-upon U.S.-China bilateral accord will be, what it is that we think we're going to get done. Because it does so, its release on April 8 had a galvanizing effect. This was true for many sectors of the business community, which until then were hopeful but not yet at all certain that their interests and needs were going to be addressed in a WTO settlement.

It also had a galvanizing effect on many in Congress who, in the silence of the two weeks preceding the premier's visit while the negotiations were in full swing behind closed doors, had expressed very clearly their concerns that a WTO deal might be made on political grounds alone, or might be made in a way that certain interests were dropped overboard so that other interests could be addressed. This April 8 document makes clear that the United States was in no way making a "political deal"; it was in no way "lowering the bar," another term that you could read in any newspaper or any opinion article in the weeks before Zhu Rongji got to the United States. And in fact, the United States was at the point of closing on a deal that went further than even most optimists in the business community had expected us to be able to go. It secured a level of apparent agreement on the Chinese side, not only to specific reductions of tariff and nontariff barriers, but to the modification of the very structures by which the Chinese economy itself is organized. It is a profoundly important document.

When a bilateral agreement between the United States and China is finally reached, I am confident that legislation will be introduced to remove China from coverage of the terms of the so-called Jackson-Vanik amendment to the Trade Act of 1974. Under that amendment, China, as a so-called nonmarket economy, is not granted unconditional, permanent NTR tariffs; instead, it is subjected to the annual review process that everyone knows so well.

The Jackson-Vanik amendment, as you

remember, was developed by Sen. Henry Jackson of Washington and Rep. Charles Vanik of Ohio as an attempt to bring the power of the United States to bear on something that we took serious objection to in the Soviet Union—the practice of imposing an exit tax on Jews seeking to immigrate to Israel. The motivation for the Jackson-Vanik amendment was specifically to create the threat that if the Soviet Union did not permit free emigration, we would cut off Soviet access to U.S. markets by withdrawing Most Favored Nation (the predecessor of NTR) status. The verbiage of the amendment was applied to all nonmarket economies. In the case of China it was a nonissue from the establishment of diplomatic and commercial relations in 1979 and 1980 until the tragedy of Tiananmen. After Tiananmen, the annual threat to close the U.S. market by denying China ordinary MFN tariffs on its exports to this country became a matter of intense congressional debate year after year.

So if we sign a bilateral WTO agreement with China (which is a prerequisite, along with China's bilateral negotiations with Japan, the European Union, and other WTO members, to its entrance to the WTO), I am very confident that legislation will be quickly introduced to remove China from the terms of Jackson-Vanik, that is, to give China permanent NTR status.

If Congress faces the vote on permanent NTR, whether it's before the August recess or later in the fall, the essence of the question that Congress will have to ask itself is this, and believe me nothing more than this:

Shall the United States say to the Chinese, from whom we have negotiated this staggering set of market-barrier reductions and market-opening commitments, "Thank you for giving us what we had demanded, after 13 years of negotiating. Thank you for giving us the commercially viable deal that we always said that we would demand and not settle for anything less. But, upon reflection, we don't

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want the benefits. We want you to give the benefits to Japan. We want you to give the benefits to Europe. We want you to give the benefits we've negotiated to every other member of the WTO. Even though we are the ones who have secured those commitments from you, we decided we don't want them after all. We would rather not have those benefits brought home to the American marketplace, to the American factory, to the American company, to the American farmer, to the American consumer?"

For the United States to reap and realize at home all of the things that we have negotiated for, apparently successfully, requires that we treat China as a WTO member. The WTO's founding document says, as a basic principle, that every member of the WTO gives every other member of the WTO permanent, unconditional MFN treatment. If the Congress were to say no to permanent NTR for China, the United States would then be obliged to avail itself of a WTO mechanism that says you can deny WTO treatment to another country, but that you don't get WTO treatment from that country in return.

Now, what China wants, obviously, at least in the case of the United States, is escape from the annual review process and permanent NTR, which is what every WTO member gives every other member. What we want are all the things in the Market Access document issued in April. The Chinese have done all the heavy lifting; it is they, not we, who are making these massive commitments to change in their economic and commercial policy and practice. So this is the question, if we are fortunate enough to close a bilateral deal, and Congress does look at legislation giving China full WTO member status: Do we want the benefits we successfully secured in a decade of arduous negotiations, or don't we?

And for that reason, we in the business community who spent a lot of time over the years on the annual MFN, or NTR, discussion believe that thoughtful members of Congress

from both parties—this is not a partisan issue—after weighing the economic and commercial dimensions of what is at stake here, and what is in the document, will reach the same conclusion on the permanent NTR issue that they have on the annual issue: that this is in America's national interest. It's in the interest of our businesses, our producers, our consumers and very heavily in the interest of American agriculture. And we believe that we will see the United States availing itself of these tremendous benefits as China steps into the WTO.

China's Leaders Committed to Economic Reform

by Nicholas Lardy

I'd like to direct most of my remarks to the process by which we get to permanent NTR status for China, that is, the WTO process and China's entry into the WTO, rather than focus on the more tactical issue of the vote for renewal of that status that was offered by the president on June 3.

Let me begin by saying I do believe and I have written that it was a mistake on the part of the administration to turn down the offer that was available in early April at the time that Zhu Rongji came to the United States. I think China's offer at that time was superb in terms of market opening to both goods and services. And I think the refusal on the part of the United States to accept the deal was a substantial setback to Zhu Rongji.

I think Zhu is determined to move China's economy much, much more toward the market and to rely much, much more on competitive forces. His offer in early April really reflected that. We should have taken it. We didn't. It was a setback both for the United States in terms of our trade relationship with China and I think also for Zhu personally in terms of moving ahead on his own agenda of domestic economic reform.

Obviously, a further setback was the bombing of the Chinese Embassy in Belgrade on May 7. I think it will be quite some time before

we know the full implications of that action and all the things surrounding it, but I think there are bound to be long-term negative consequences. The real question is how large they will be.

In an attempt to recoup the loss of the major agreement on the WTO, the administration did announce on April 10 that we had an agreement on agriculture that covered wheat, citrus, and meat. In fact, it's not at all clear to me that we do have such an agreement. The text of the agreement has never been released. The administration offered a series of excuses between April 10 and May 7 for why the agreement hadn't yet been released. Obviously, the bombing has compounded whatever the underlying problems are. And so what was described as an immediate market-opening measure does not really seem to be in hand. And I think it very much hangs in the balance, as does the overall negotiation on China's accession to the WTO.

Economic Troubles Spur Reforms

An appreciation of deteriorating domestic economic conditions in China is essential to understanding China's negotiating posture and really essential to understanding what I said was Zhu Rongji's extraordinary commitment to increasing the role of the market in that economy.

China currently faces an unprecedented combination of declining exports, declining foreign direct investment (FDI), and a decline in the willingness of international banks to lend to it. China has, over the last two decades, not encountered any single one of those situations, and obviously the three together put enormous pressure on the economy and eventually will put quite some pressure on the currency as well. In other words, if we look over the last 20 years, every year China has had more FDI and has exported significantly more than the year before. And in most years, particularly in the last decade, China has also borrowed more funds from international banks to help finance its own development.

Now, in the wake of the Asian crisis, the banks are pulling their credit lines to China,

and FDI is actually declining. FDI is still at a fairly high level, but it is nonetheless going down significantly for the first time. And export growth has come to a halt as it did in 1998; indeed, in the first five months of this year exports were down significantly and China's trade surplus had actually shrunk by about 60 percent compared to the first five months of 1998. If current trends continue, China is going to have a current account deficit in 1999, its first since 1993.

A second problem the Chinese face is that consumption growth remains fairly anemic, on the order of about 4 to 5 percent per year. Consumer confidence, of course, is the underlying problem, given all the industrial restructuring and other changes in the domestic economy. People are saving more in anticipation of the possibility of losing their jobs or of otherwise being directly affected by the restructuring, which is a very important ongoing part of Zhu's reform program. Consumption demand, in other words, has not been a big engine of growth in this economy in the last two years. It was in prior years. So in addition to the decline in exports, which is detracting from the growth of aggregate demand, consumption growth is fairly anemic.

That leaves investment-led growth as the major source of growth over the last year and continuing into 1999. But I think the problem China faces is that its fiscal and banking systems are really too weak to sustain investment-led growth for a long period of time. We already are in a situation where an extraordinarily high share of central government expenditures is financed by the sale of treasury bonds to the public. Indeed, about 80 percent of all central government expenditures are now financed not from tax revenues but from selling bonds to raise revenues. There are very few countries in the world where the share of government expenditures financed through the sale of bonds is so high.

The ratio of debt to gross domestic product is rising at a fairly rapid rate, which suggests the growth of government debt outstanding is increasing at a rate that will not be sustainable over time. The Chinese have relied to some

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We should drop our demand that China agree to standards that are much more onerous than those imposed on all other WTO members.

extent on increased bank lending to finance the infrastructure program, but that has also contributed to a further weakening of an already fragile banking system.

So basically if you look at the kind of broad macroeconomic picture that shows growth from exports, consumption, or investment, you see that the export engine has shut down and consumption demand is weak. The economy has been sustained at a reasonable level through increased investment demand, but this looks increasingly problematic as you go forward. So the economy is really in a fairly weak position, particularly if you look at the long-term growth during the past two decades of very rapid economic growth and opening to the outside world.

But what are the implications for China's drive for WTO membership? I don't think there is any doubt that WTO membership would provide long-term benefits to China in terms of improving the efficiency of resource allocation through much more competition in the economy, which would stimulate improvements in resource allocation, in efficiency, and in the rate of economic growth for any given level of investment.

The problem is that, in the short term, WTO accession is certain to exacerbate many underlying problems. Unemployment is already at a 30-year high and will probably go higher at least in the short run. Workers are going to have to be laid off in the short run as they are subject to more competition in sectors where China is not competitive. Over time I think all of those workers will be reemployed, or at least the great majority will be reemployed, in other sectors where China really does have a comparative advantage. But in the short run the adjustment costs are going to be very substantial.

WTO membership could also exacerbate problems of deflation, which, as I already indicated, are quite substantial because of excess capacity across such a broad range of industries, declining consumer demand, and declining price levels both at the retail level and at the consumer price index level as disclosed by the Chinese.

Drop Unreasonable U.S. Demands

What is the way forward in this environment? Several things have to be done. First of all, there does have to be some kind of resolution of the agricultural agreement that was announced on April 10. The Chinese are going to have to, I think, agree to the English-language text that Madame Wu Yi signed on April 10, and then I think China should begin to take very expeditious steps to actually implement that agreement. Not only do we apparently not have an agreement at the moment, the Chinese are also not taking any of the steps that will be required to actually implement the agreement if indeed we do have it.

So the Chinese have to agree to the English-language text and take expeditious steps to implement the actual provisions of that agreement, which is quite separate economically from the WTO agreement. But politically, the issue is obviously quite important because of the large numbers of votes in farm states in very, very diverse areas: California, the central states, the wheat-growing states, Florida, and so forth.

On the U.S. side, the argument that was used to explain why the president turned down the WTO agreement in early April involved a number of claims that we were going to "improve the agreement" by getting the Chinese to agree to more favorable provisions, particularly on three protocol issues. I think the only way forward is for the United States basically to drop all of these demands.

We should drop the demand, for example, that China agree to an additional five years on the phaseout of textile quotas, which I think was an unconscionable demand to begin with.

Second, we should drop our demand that China agree to allow the United States to continue to use the nonmarket methodology in antidumping cases for a period longer than five years. China is coming into compliance with almost every single WTO requirement within that five-year period, so we should give up on any demand to have China agree to that procedure for a period beyond five years.

Third, we should drop our demand that China agree to safeguard standards that are

much more onerous than those imposed on all other WTO members. I don't see how we can expect the Chinese to agree to be treated in a discriminatory fashion. We stand up and preach about the benefits of free trade and then we say, "Oh, by the way, we want to impose on you these special agreements that will allow us to discriminate against you." I think that has to be dropped.

The third thing that has to happen, of course, is that the Chinese have to keep on the table the substantive details of their early April offer for their accession to the WTO. There have been lots of comments in the Chinese press to the effect that yes, maybe they said at one time they were going to do this and that and the other thing, but all this, or at least key components of this, have supposedly been withdrawn. At least they've been withdrawn in the press. They have not been withdrawn in any official bilateral discussions with the United States. But I think if we're going to move forward, the Chinese side is going to have to keep substantially intact the shape of that offer as it existed in early April.

So in short we've got to have three things happen: We've got to get the agriculture agreement back on track. The Chinese have to agree to implement it on an expedited basis. The U.S. side should drop its outrageous demands on the protocol issues. And the Chinese side should agree to keep on the table most of the substantive details that were there in early April. I think if those three things can be done there is some basis for believing we can have a Chinese accession or an agreement for Chinese accession to the WTO prior to the end of the current calendar year. That would certainly be of long-term benefit for China's economic reform and also for U.S. exporters who would get much, much greater permanent access to the Chinese market.

China and Intellectual Property Rights

The following remarks were made in response to a question from the audience about whether China would still need to abide by existing agreements with the United States on enforcing intellectual property rights.

My understanding is that the Chinese have agreed to come into compliance with all of the WTO principles on intellectual property rights (IPR) immediately upon accession. The real problem is that it's fine to accept the principles, but do the Chinese have the ability, even if they have the intention, to live up to the principles? Do they have the ability to actually enforce those principles across their large country? I think the record is actually reasonably good.

If you go back and look at what the IPR agreement with the United States called for and read the most recent U.S. Trade Representative report, you find that the Chinese, by and large, did everything they agreed to. They have closed down 74 production lines that were producing illegal material, both video and audio. The problem that has arisen is that there are new sources of supply. Illegal goods now come primarily from Hong Kong and Macao, and the stuff is being smuggled into China and is still, apparently, fairly widely available. So the estimates of the share of the total product that is illegal or not in compliance and of market losses are still very, very high. So, what we asked the Chinese to do, by and large, they have done. They've closed down the illegal production lines.

Now what they've got to do is to impose much stronger border controls. Again, look at the way that USTR has dealt with Hong Kong: they took Hong Kong off the watch list because they think Hong Kong has started to implement stronger procedures. I think the main problem, at least as I understand it now, is Macao. And I don't know how that will be dealt with.

The United States will have available all of the instruments we had prior to China's accession to the WTO. And I think, quite frankly, we'll be much better off because we will also be able to use the multilateral WTO dispute settlement process and we will bring international pressure to bear on the Chinese. They will be in violation of not just a bilateral agreement with the United States but also of their multilateral obligations under the WTO.

Chinese accession to the WTO would be of long-term benefit for China's economic reform and also for U.S. exporters who would get much, much greater permanent access to the Chinese market.

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