

CRS Report for Congress

Received through the CRS Web

China and the World Trade Organization

Wayne M. Morrison
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

Summary

After many years of difficult negotiations, China, on December 11, 2001, became a member of the World Trade Organization (WTO), the international agency that administers multilateral trade rules. Under the terms of its WTO membership, China agreed to significantly liberalize its trade and investment regimes, which could produce significant new commercial opportunities for U.S. businesses. A main concern for Congress is to ensure that China fully complies with its WTO commitments. According to U.S. government officials and many business representatives, China's WTO compliance record has been mixed. This report will be updated as events warrant.

After 15 years of bilateral and multilateral negotiations, China formally entered the WTO on December 11, 2001. The negotiations on China's accession to the WTO focused on many Chinese practices that distort flows of trade to and from China, such as high tariffs and non-tariff barriers, restrictions on foreign investment, lack of national treatment for foreign firms, inadequate protection of intellectual property rights (IPR), and trade-distorting government subsidies. Membership in the WTO requires China to change many laws, institutions, and policies to bring them into conformity with WTO rules.¹

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

¹ For additional information on China's WTO accession and other topics in U.S.-China trade relations, see CRS Issue Brief 91121, *China-U.S. Trade Issues*, updated regularly.

The Role and Interest of the United States

China has been one of the world's fastest growing economies over the past several years (real GDP growth averaged 9.3% annually from 1979 to 2002), and many trade analysts argue that China could become a potentially large market for a wide variety of U.S. goods and services. 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.² The growing importance of China in the world economy was an important factor in the heightened interest among WTO members in bringing China into the WTO and thereby subjecting its trade regime to multilateral trade rules.

U.S. trade officials insisted that China's entry into the WTO had to be based on "commercially meaningful terms" that would require China to significantly reduce trade and investment barriers within a relatively short period of time. Many U.S. trade analysts viewed China's WTO accession process as an opportunity for gaining substantially greater access to China's market and to help reduce the large and increasing U.S.-China trade imbalance. Other U.S. proponents of China's WTO membership contended that it 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.

China Joins the WTO

China completed all of its WTO bilateral agreements on September 13, 2001 (it concluded an agreement with the United States on November 15, 1999) and completed negotiations with the WTO Working Party handling its accession bid on September 17, 2001. China's WTO membership was formally approved by the WTO on November 10, 2001, and on the following day, China informed the WTO that it had ratified the WTO agreements. As a result, China officially joined the WTO on December 11, 2001.

Under the WTO accession agreement, China agreed to:

- Bind all tariffs. The average tariff for industrial goods will fall to 8.9% and to 15% for agriculture. Most tariff cuts will be made by 2004; all cuts will occur by 2010.
- Limit subsidies for agricultural production to 8.5% of the value of farm output and will not maintain export subsidies on agricultural exports.
- Within three years of accession, grant full trade and distribution rights to foreign enterprises (with some exceptions, such as for certain agricultural products, minerals, and fuels).
- Provide non-discriminatory treatment to all WTO members. Foreign firms in China will be treated no less favorably than Chinese firms for trade purposes. Dual pricing practices will be eliminated as well as

² The World Bank, *China 2020: China Engaged*, 1997, p. 31.

differences in the treatment of goods produced in China for the domestic market as oppose to those goods produced for export. Price controls will not be used to provide protection to Chinese firms.

- Implement the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement upon accession.
- Accept a 12-year safeguard mechanism, available to other WTO members in cases where a surge in Chinese exports cause or threaten to cause market disruption to domestic producers.
- Fully open the banking system to foreign financial institutions within five years. Joint ventures in insurance and telecommunication will be permitted (with various degrees of foreign ownership allowed).

The Role of Congress

Congress did not play a direct role in the WTO accession process. That is, current U.S. law did not require congressional approval of the November 1999 U.S.-China WTO trade agreement, nor was it needed for the United States to support China's admission to the WTO. However, in order to ensure that the WTO agreements would apply between the United States and China, Congress passed H.R. 4444 (P.L. 106-286), granting the President authority to extend permanent normal trade relations (PNTR) status to China upon its accession to the WTO.³ The bill also established a special Congressional-Executive commission to monitor and report on various aspects of China's policies on human rights (including labor practices and religious freedom) and ordered the U.S. Trade Representative (USTR) to annually issue a report assessing China's compliance with its WTO trade obligations. On December 27, 2001, President Bush issued a proclamation granting PNTR status to China effective January 1, 2002.

WTO Implementation Issues

China's implementation of its WTO commitments has been closely followed by U.S. officials and various business groups. On December 11, 2002, the USTR released its first annual China WTO compliance report.⁴ Although stating that China had made significant overall progress in meeting its WTO obligations, the report raised serious concerns over China's compliance with its commitments on agriculture, services, IPR protection, and transparency of trade laws and regulations. On June 18, 2003, the U.S.-China Business Council (USCBC) issued its mid-year 2003 report on China's WTO implementation.⁵ The report stated that, while China has promptly implemented its WTO

³ Prior U.S. law required China's NTR status to be renewed on an annual basis (which it was from 1980 to 2001); a measure many analysts considered inconsistent with WTO rules if applied to a WTO member. Without a change in law, the United States would have been forced to invoke Article XIII in the WTO, the non-application clause, towards China.

⁴ USTR, *2002 Report to Congress on China's WTO Compliance*, December 11, 2002.

⁵ The U.S.-China Business Council, *China's WTO Implementation: A Mid-Year Assessment*, June (continued...)

tariff-reduction commitments, it has failed to fulfill its obligations in a number of areas, including the removal of agricultural and industrial quotas and tariff-rate quotas, unreasonable standards for genetically modified organisms applied to agricultural trade, high capital requirements for establishment of services businesses, discriminatory tax policies on imports, failure to issue promised regulations for auto finance operations, insufficient regulatory transparency, and lack of protection for U.S. intellectual property rights. The USCBC noted “growing concerns” among U.S. firms over China’s ability to deliver on key commitments on time and in full.

Some analysts argue that China’s compliance with its WTO obligations is being hampered by resistance to reforms by central and local government officials seeking to protect or promote industries under their jurisdictions, government corruption, and lack of resources devoted by the central government to ensure that WTO reforms are carried out in a uniform and consistent manner (especially in regards to IPR enforcement). Although Chinese government officials have promised to implement WTO related reforms, they have raised concerns that such reforms could cause major employment disruptions in certain sensitive sectors, especially agriculture, that could result in social instability.

U.S. officials have raised a number of implementation issues with Chinese officials over the past year:

- **Soybeans.** China is a major soybean importer. The United States exports about \$1 billion in soybeans to China annually, making it the top foreign purchaser of U.S. soybeans. In June 2001, China announced it would implement new rules on bio-engineered foods, effective in 2002. However, China did not provide details of these rules, which led to a disruption in U.S. soybean exports to China from January-March 2002. President Bush raised the issue with Chinese President Jiang Zemin in October 2001 and in March 2002, which led China to agree to the interim use of U.S. and foreign safety certificates until China implements its new biotechnology regulations. On October 18, 2002, China issued regulations applying this policy through September 2003; the USTR’s office stated that the regulation “should remove the threat of an interruption of U.S. soybean sales to China.”⁶ In July 2003 China further extended the policy through April 2004. However, U.S. exporters have complained that the regulations require each GMO shipment have an interim biotech safety certificate and a Chinese government import license. Additionally, in January 2003, the Chinese government indicated that it might delay permanent approval of various GMO crops and might require another round of food safety studies, a move that led the U.S. to issue an official protest. Some analysts charge that China may be attempting to use such regulations to limit biotech imports in order to protect its domestic producers as well as its own biotech industries. U.S. officials have warned that they make take this issue to

⁵ (...continued)
2003.

⁶ USTR Press Release, October 18, 2003.

the WTO for resolution. Despite these problems, U.S. soybean exports to China have increased significantly in 2003, rising by nearly 209% from January-May 2003 over the same period in 2002.⁷

- **Tariff-rate quotas.** In November 2001, the Chinese government developed new rules on tariff-rate-quotas on certain agricultural products that the U.S. charged were discriminatory and violated WTO rules because they created two categories of import quota licenses: one for domestic consumption and one for “processing” trade. The U.S. further charged that China has failed to provide adequate information on the administration of its tariff-rate quotas (TRQs) for farm commodities. In July 2002, the U.S. Department of Agriculture (USDA) reported that China’s TRQ licenses had authorized relatively small levels of imports, making their use impractical.⁸ U.S. firms charge that this allocation policy violates WTO rules on national treatment. In other instances, China announced TRQs for various agriculture and manufactured products several months after their required implementation date. In December 2002, USTR Robert Zoellick sent a letter to China’s Ministry of Foreign Trade and Economic Cooperation (MOFTEC) expressing U.S. concern over China’s administration of TRQs. In January 2003, Zoellick was quoted in the press as saying that the TRQ issue was “one of the areas we’re most frustrated with” in terms of China’s WTO compliance.
- **Export subsidies and discriminatory taxes.** U.S. officials charge that China has subsidized grain exports (mainly corn) and cotton, and uses its tax system to promote exports and discourage imports, contrary to its WTO commitments. For example, China continues to give rebates on value-added taxes (VAT) for certain exports, especially high tech. In some instances, China imposes higher VAT rates on certain imported products (such as fertilizers and various agricultural products) than it does for similar products produced domestically.
- **Autos.** Some U.S. businesses claim that China has failed to fully implement its commitments on autos, especially in regards to quota allocations, trading rights for foreign firms, and local content requirements. Another major concern is China’s high capital requirements for non-banks offering auto financing, which, U.S. firms charge, negatively affect small firms.
- **Services.** U.S. firms have complained that Chinese regulations on services are confusing and often discriminatory. China maintains high capital requirements, restrictions on branching, and prudential requirements (e.g., already operating in China for a certain number of

⁷ In fact, U.S. soybean exports to China over the first five months of 2003 (\$1.1 billion) are already higher than U.S. soybean exports to China for the entire year in 2002 (\$0.9 billion).

⁸ For example, under the WTO accession agreement, China’s TRQ for cotton in 2002 was 818,500 tons. In June 2002, China announced that 500,000 tons of the TRQ would be allocated for processing trade, 270,000 tons for state-owned mills, and 48,500 tons for private mills.

years, profit requirements, etc.). In order for firms to enter the market. In addition, many U.S. firms have complained that they have not been afforded the extent of market access promised under China's WTO accord, especially in regards to geographic market access and the amount of foreign ownership allowed for insurance and telecommunications companies in China.

- **Health and safety requirements.** U.S. officials charge that China continues to use a variety of health and safety regulations to effectively bar foreign imports, especially food products (such as wheat, poultry and meats, and citrus). Many of these issues were supposed to have been resolved under a 1999 agreement with China.
- **IPR.** While China has enacted a variety of new IPR laws, enforcement of those laws remains relatively weak.

Implications for U.S.-China Commercial Relations

China's WTO accession is expected to provide a major boost to China's economy, especially in its ability to attract foreign investment. In 2002, China became the world's largest recipient of foreign direct investment. China has become the United States' third largest source of imports. During the first five months of 2003, U.S. imports from China rose by 28% over the same period in 2002, higher than those of any other major U.S. import supplier.⁹ Representatives from several manufacturing sectors and labor unions have complained over the competitive challenge posed by low-cost Chinese goods. Some businesses (particularly the U.S. textile sector) are advocating for the imposition of special safeguard provisions to restrict the amount of Chinese exports to the United States.¹⁰ Other groups have argued that China manipulates its currency by pegging it the U.S. dollar, making Chinese exports cheaper and imports more expensive, than would occur if China's currency (the yuan) was fully convertible. Such groups want the Bush Administration to pressure China to appreciate the yuan or make it fully convertible.

Congress will likely continue to press the Bush Administration to ensure China's compliance with its WTO commitments.¹¹ Some Members have called on the Administration to file dispute resolution cases against China in the WTO if it fails to resolve outstanding disputes with the United States over its compliance with WTO rules.

⁹ At the same time, U.S. exports to China are rising faster than those to any other major trading partner. During the first five months of 2003, they rose by nearly 32%. However, since U.S. imports from China are already much larger than U.S. exports to China, the U.S. trade deficit with China (which totaled \$103 billion in 2002) is currently projected to rise to about \$130 billion in 2003.

¹⁰ The United States maintains quotas on textile imports from China, but WTO rules require the quotas to be phased out by 2005. As a result, U.S. textile imports from China are expected to rise sharply.

¹¹ In July 2003, the House of Representatives passed legislation (H.R. 2799) that would appropriate \$3 million to establish a new Office of China Compliance (within the USTR's office) to focus on compliance issues of concern to small-and-medium sized businesses.