

U.S.-CHINA TRADE:  
Smooth Sailing or Choppy Waters?

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## INTRODUCTION

In quantitative terms, the last two decades have been spectacularly successful for U.S.-China trade. In the late 1970s, U.S.-China trade was at a very low level. But the establishment of strengthened ties between Washington and Beijing and China's decision to begin reforming its economy and expanding economic ties with the West set off a tremendous surge of growth in trade and investment. In 2000, total trade between the United States and China is likely to top \$100 billion. China has become one of the United States' top five trading partners and the United States is by far the largest market for Chinese exports. Paralleling and supporting the increased levels of trade, investment – mostly investment by U.S. companies investing in China – has also grown steadily.

The large trade and investment flows, however, have not secured a smooth trading relationship. U.S.-China tensions have risen in the last eleven years. The first major source of tension was China's massacre of demonstrators at Tiananmen Square in 1989, but since then disputes have also flared over religious toleration in China, China's posture toward Taiwan, arms sales to rogue states and a series of other issues.

These diverse issues have all impacted U.S.-China commerce in a number of ways. The most significant of which was that China's critics in the United States Congress threatened to withdraw Most Favored Nation (MFN) trade treatment (now known in the United States as Normal Trade Relations or NTR) from China to punish it for actions on these and other fronts.

Trade itself has also sparked disputes. The United States has pressed China to undertake economic reforms to protect intellectual property, open its market to U.S. exports, stop exports of goods made with prison labor, and undertake other trade reforms. At several junctures, the United States was close to imposing trade sanctions over intellectual property piracy and market access disputes. On the import side, China has also become the leading target of action under U.S. trade laws against dumping, or unfair pricing of imports.

After arduous negotiations that took nearly a decade and a half, China has negotiated to join the world trading system now known as the World Trade Organization (WTO). As China's leading trade partner and an influential member of the WTO, the United States has taken a leading role in WTO accession negotiations. At times, these negotiations have contributed to bilateral tensions, but they have also provided a promising opportunity to address a range of bilateral trade concerns in a multilateral forum.

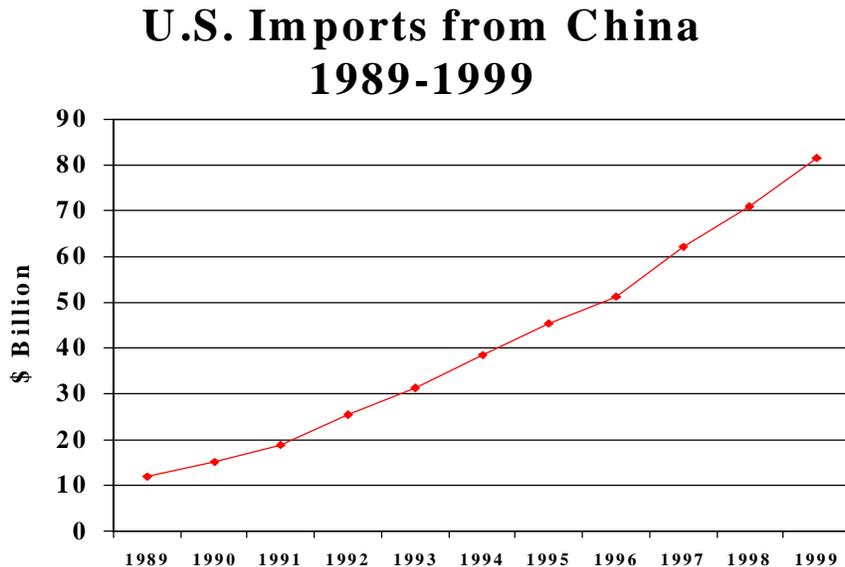
This year, China is likely to become a WTO member. This will be a fundamental change in U.S.-China relations. The United States will no longer be able to freely threaten China with unilateral trade sanctions and many current disputes will likely eventually be addressed in the context of the WTO. In some areas, however, China will likely have difficulty meeting WTO standards for its trade policies. This may lead to a number of new U.S.-China disputes in the WTO.

This paper attempts to analyze the current and likely future U.S.-China trade relationship. Particular emphasis will be given to outstanding disputes over Chinese trade policies and current Chinese trade barriers. The likely role of the WTO in addressing these issues in the future will be given special attention.

## OVERVIEW OF TRADE FLOWS

### Imports

The bulk of the dramatic increase in U.S. trade with China came and continues to come in the form of imports from China. As is demonstrated by the attached chart, U.S. imports from China increased at a near exponential pace in the 1990s. In 1999, imports from China grew at a nearly 15 percent annual rate – by far, the fastest growing source of U.S. imports.



*Source: USITC Interactive Tariff and Trade Data Web*

As is to be expected given China's level of development, the bulk of U.S. imports from China are relatively simple manufactured products, like footwear and toys.

## **Top 5 U.S. Imports from China - 1999**

1. Toys, Games and Sporting Goods
2. Footwear
3. Telecommunications Equipment
4. Computers and Automatic Data Processing Machines
5. Office Machinery and Parts

*Source: U.S. Department of Commerce*

Many of these imports – though not all – do not directly compete with U.S. products. As a result, much of the increase in Chinese exports to the United States has come at the expense of exporters in third countries, such as Mexico, South Korea, and Taiwan, not directly at the expense of U.S. manufacturers.<sup>1</sup> That said, however, the impacts are not necessarily costless. For example, there might be strong foreign policy reasons why development in Mexico may be preferable to development in China for the United States. There may also be an interest in encouraging economic recovery in those countries that fell victim to the Asian crisis as opposed to China. Further, it may be that a greater

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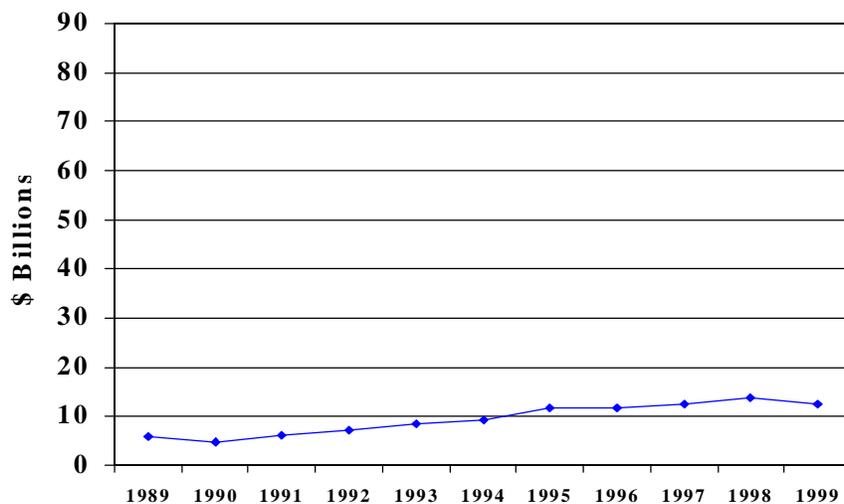
<sup>1</sup> See Marcus Noland, “US-China Economic Relations,” *After the Cold War: Domestic Factors and US-China Relations*, Ed. Robert S. Ross (Armonk, NY: M.E. Sharpe, 1998); Nicholas Lardy, “China’s WTO Membership,” *Brookings Policy Brief #47* (Washington, DC: Brookings Institution, April 1999); and Daniel H. Rosen, “China and the World Trade Organization: An Economic Balance Sheet,” *International Economics Policy Briefs* (Washington, DC: Institute for International Economics, June 1999).

percentage of U.S. dollars used to purchase imports are recycled to purchase imports from the United States in Mexico than in China.

The character of imports from China is also shifting to increasingly sophisticated categories of products. Telecommunications equipment, computers, and office machinery are all among the top five import categories from China. Although the opening of the United States textile and apparel market may at least temporarily reverse this trend, higher value product categories of imports from China will likely remain among the fastest growing.

Exports to China from the United States also grew in the 1990s, but the growth of exports was much less pronounced than growth of imports. In fact, in 1999 exports to China actually dipped slightly – about 8 percent -- from 1998.

## U.S. Exports to China 1989-1999



*Source: USITC Interactive Tariff and Trade Data Web*

China does remain one of the United States fastest growing export markets in percentage terms, but this has much to do with the low initial base of exports. U.S. exports to China have actually grown more slowly than those of the European Union.<sup>2</sup>

As would be expected, the chief U.S. exports to China are primarily sophisticated manufactured products, like aircraft, telecommunications equipment, and semiconductors. Fertilizer exports are also a top item to China. In many years, U.S. agricultural exports also rank near the top.

## **Top 5 U.S. Exports to China - 1999**

1. Aircraft and Aircraft Equipment
2. Fertilizers
3. Telecommunications Equipment
4. Computers and Computer Equipment
5. Semiconductors, Transistors and Diodes

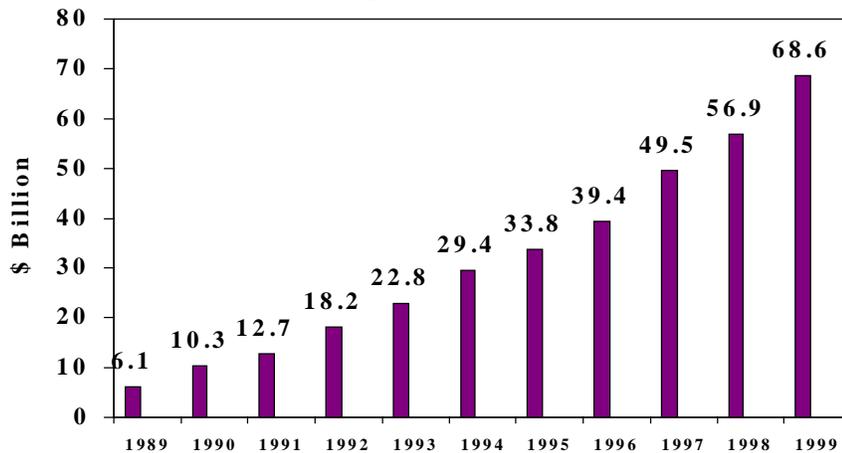
*Source: U.S. Department of Commerce*

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<sup>2</sup> Between 1996 and 1999, U.S. exports to China increased 9.3%, while EU exports to China increased 11.2% (Data taken from the Commerce Department and Eurostat). See also U.S. International Trade Commission (USITC), *Assessment of the Economic Effects on the United States of China's Accession to the WTO* (Washington, DC: USITC, September 1999) pp. 2:4.

The combined impact of the above trends is a rapidly rising U.S. trade deficit with China.

### The U.S.-China Trade Deficit 1989-1999



Source: USITC Interactive Tariff and Trade Data Web

Barring unexpected developments, the U.S. trade deficit with China is likely to soon become the largest single bilateral trade deficit, surpassing Japan. The impact of China's WTO accession on the U.S.-China trade deficit is debatable. Some analysts argue that WTO membership will expand U.S. market opportunities in China, which will reduce the size of the trade imbalance.<sup>3</sup> Others, noting that the more rapid phase out of U.S. restrictions on China's textile and apparel imports necessitated by WTO membership, predict that membership will expand the trade imbalance.<sup>4</sup> Given the already significant

<sup>3</sup> See Rosen, "China and the World Trade Organization," and Mark A. Groombridge, "China's Long March to a Market Economy: The Case for Permanent Normal Trade Relations with the People's Republic of China," *Cato Trade Policy Analysis* (Washington, DC: Cato Institute, April 24, 2000).

<sup>4</sup>See Robert E. Scott, "China and the States," *EPI Briefing Paper* (Washington, DC: Economic Policy Institute, May 2000).

size, it seems certain that a substantial trade deficit will be an ongoing reality of U.S.-China trade relations.

Some observers argue that the size of the U.S. trade deficit with China is overstated because of the close economic relationship between Hong Kong and China. Noting that many products marked as originating in China have some Hong Kong input and that some products exported to Hong Kong ultimately end up in China, some argue that the size of the deficit should be substantially reduced.<sup>5</sup> This argument has some limitations, however.

The situation with China and Hong Kong is not unique; imports attributed to many countries have input from elsewhere. For example, many Asian manufacturers have established operations in Mexico and Canada, which export products to the United States with substantial Asian input though they are counted as Mexican or Canadian production. The U.S. Customs Service applies the same set of rules for determining origin to imports from China and Hong Kong that it applies to imports from everywhere else in the world. Thus, it is difficult to see an analytical basis for changing the way in which the deficit with China is calculated without undertaking similar changes with all other trading partners.

Beyond that, advocates of the Hong Kong adjustment consistently ignore Chinese textile and apparel products illegally transshipped through Hong Kong to avoid U.S.

restrictions. According to the U.S. Customs Service, a proper accounting of these products would actually expand the U.S. trade deficit with China by several billion dollars per year.<sup>6</sup>

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<sup>5</sup> For example, see Gary Clyde Hufbauer and Daniel H. Rosen, “American Access to China’s Market: The Congressional Vote on PNTR,” *International Economics Policy Briefs* (Washington, DC: Institute for International Economics, April 2000) Appendix B.

<sup>6</sup> U.S. Customs Service, *Textile Transshipment Report* (Washington, DC: U.S. Customs Service, March 1998) pp. 6, 14. Available at [www.customs.gov/quotas/ttr/newrpt19.pdf](http://www.customs.gov/quotas/ttr/newrpt19.pdf).

## CHINESE TRADE POLICY

Chinese international trade policy has changed dramatically over the last two decades. Consistent with its Communist philosophy, China under Mao traded little with the West. The limited trade that China did undertake was primarily with other non-market countries, such as the Soviet Union and North Korea.

In the mid 1970s, however, the political breach with the Soviet Union, improved ties with the United States, and considerable internal sentiment in favor of economic reform allowed China to adopt limited market reforms and expand economic ties with the West. Under the leadership of Deng Xiao Peng,<sup>7</sup> China undertook a long-term reform program that included a number of steps to attract foreign investment and trade, including the creation of Foreign Enterprise Zones, which encouraged western companies to establish factories in China largely to assemble products from western inputs.<sup>8</sup> As noted in the previous section, if the program is measured in terms of FDI attracted and new export markets opened it was a spectacular success. Largely as a result, China has enjoyed two decades of strong economic growth at near double-digit rates.<sup>9</sup>

From the outset, however, China's embrace of market reform was not complete. It is difficult to determine exactly what the ultimate goal of Chinese economic reform

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<sup>7</sup> For a brief summary of Deng's (1904-1997) economic reforms, see Harry Harding, *A Fragile Relationship: The United States and China Since 1972* (Washington, DC: Brookings Institution, 1992) pp. 67-137.

<sup>8</sup> Greg Mastel, *The Rise of the Chinese Economy: The Middle Kingdom Emerges* (Armonk, NY: M.E. Sharpe, 1997) pp. 3-4 and Harold K. Jacobson and Michael K. Oksenberg, *China's Participation in the IMF, the World Bank and the GATT: Toward a Global Economic Order* (Ann Arbor, MI: University of Michigan Press, 1990).

<sup>9</sup> According to the International Monetary Fund's *World Economic Outlook* (2000 Edition), China averaged an annual growth rate of 10 percent between 1982 and 1999.

was, but leaders talked about a concept of “socialism with Chinese characteristics.”<sup>10</sup>

Various leaders probably differed on some of the details of this vision, but it clearly involved a Chinese economy that was much more market oriented than that envisioned by Chairman Mao Tse Tung.

### Current Chinese Attitudes

China’s leaders have not increased the specificity of their economic vision much beyond “Socialism with Chinese characteristics.” China’s Premier and apparent second in command, Zhu Rhongji, appears to embrace broader economic reform, including considerable reforms of China’s large state-owned sector, which represents a substantial barrier to China becoming a true market economy.<sup>11</sup> Zhu’s reform agenda appears to wax and wane, however, within China.<sup>12</sup>

Despite some apparent uncertainties about the pace and wisdom of economic reform, China has consistently sought WTO membership over the last decade and a half. At the outset, China’s leadership may not have bargained on the need to embrace real reform to join the WTO. Initially, China’s efforts appear to have been driven mainly by the desire to achieve international recognition. Perhaps as a result, WTO membership has not always been the top priority of China’s leaders.

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<sup>10</sup> Former Premier Li Peng was quoted as saying, “The socialist system is worthy of being the right choice of the Chinese people... We must ceaselessly push forward the building of modern socialism...” This sentiment was also expressed in a number of economic plans put forward by the central government. See Benjamin Kang Lim, “Socialism Right Choice for China – Premier Li Peng,” *Reuters World Service*, July 29, 1996 and Mastel, *The Rise of the Chinese Economy*, pp. 71-73.

<sup>11</sup> In his March 5, 2000 “Report on the Work of the Government” (available at [www.fmprc.gov.cn/english](http://www.fmprc.gov.cn/english)), Zhu Rhongji stated, “Reform of state-owned enterprises is a key link in our efforts to deepen economic restructuring.”

Nonetheless, in the last two years, apparently driven by Premier Zhu, China has made a strong push for WTO membership that seems likely to succeed in 2000. China's top leaders – Jiang Zemin and Zhu Rhongji – have been unambiguous in their support for China's WTO membership. Zhu's willingness to make commitments to pave the way for China's WTO membership surprised many western observers. In fact, there was considerable speculation that he exceeded the mandate to make concessions that he had received from Beijing's Politburo.<sup>13</sup>

After the list of concessions that Zhu had promised in return for WTO membership became clear, the widespread opposition to WTO reforms in China became much more public. Apparently under the loose leadership of the head of the People's Congress, Li Peng – the de facto number three leader in China, a coalition of government ministries opposed to reform, state-owned enterprises, and others threatened by market reforms made their concerns more public.<sup>14</sup> In the negotiations to close the U.S.-China portion of the accession agreement in the fall of 1999, government ministries in charge of regulating segments of the economy, such as heavy industry, telecommunications, and the Internet, fought hard against Chinese concessions relevant to their operations.<sup>15</sup>

Chinese opposition to WTO accession is less visible since the U.S.-Chinese negotiations ended, but likely continues to exist. It could easily become visible again as

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<sup>12</sup> For a discussion of this, see John Maggs, "Can China Deliver on the Trade Deal," *The National Journal*, Vol. 31 No. 47, December 4, 1999.

<sup>13</sup> Todd Crowell and David Hsieh, "The Return of Zhu Rhongji," *Asiaweek*, November 26, 1999.

<sup>14</sup> Dexter Roberts and Paul Magnusson, "WTO or Bust," *Business Week*, November 22, 1999, pp. 60.

accession talks are wrapped up, as layoffs in the state-owned sector continue, or as the WTO agreement is actually implemented in China. The periodic indications of regional civil disruptions tied to state-owned industry layoffs or agriculture reform provide some indications that problems continue in China.<sup>16</sup>

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<sup>15</sup> Roberts and Magnusson, "WTO or Bust," pp. 60.

<sup>16</sup> See Erik Eckholm, "Workers in China Are Losing Patience," *International Herald Tribune*, May 17, 2000 and John Leicester, "Protest Highlights Tensions as China Moves Into Global Economy," *The Associated Press*, January 20, 2000.

## CHINESE TRADE BARRIERS

As the process of economic reform has proceeded in China, trade restrictions in many areas have been liberalized. Some of this liberalization is likely in response to pressure from western governments, notably the United States, but most has likely been to further China's internal reform process. In order to lure western capital and assembly plants to China, the government has been forced to liberalize imports of many products, particularly input products. Further, Chinese companies that are forced to compete with western companies have sought and received increased opportunities to engage in commerce with the outside world. Most of the trade reforms that China has undertaken to this point seem aimed at facilitating China's domestic economic goals of attracting investment, securing export markets, and generally supporting reform efforts.

The overall level of Chinese openness to foreign trade is difficult to gauge. Unlike Japan and South Korea, China's development effort has relied heavily upon western companies as sources of capital and technology.<sup>17</sup> Thus, foreign companies are more involved in the Chinese economy now than they were at comparable points in Japanese or South Korean development.

This has led some observers to declare that China is as open to foreign commerce as many of its neighbors, who are already in the WTO.<sup>18</sup> As just noted, at one level this

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<sup>17</sup> USITC, *Assessment of...*, pp. 2:14 – 2:24.

<sup>18</sup> For example, the Institute for International Economics' Daniel Rosen remarks, "...[T]he Chinese economy is more open than commonly thought. This is impressive given the less developed character of the Chinese economy, which stands decades behind South Korea and Japan in overall economic development yet compares well in trade protection terms." (*China and the World Trade Organization: An Economic Balance Sheet*).

statement is surely true, but it remains to be seen whether the early reliance on western companies to accelerate Chinese development truly indicates that China is moving toward an open economy. In fact, there are strong indications in Ministry statements and elsewhere that China is aiming to ultimately develop Chinese manufacturers – separate from western companies – in important manufacturing sectors. Further, the openness to western investment has not necessarily been tied to openness to western exports; as described below, many trade barriers continue to exist in China. China seems to have a strong preference for western companies that operate manufacturing in China, as opposed to exporting to China from their home markets.<sup>19</sup>

As will be clear in the discussion below, in many areas China maintains duplicative or overlapping trade barriers. In other words, particular sectors may not be blocked by only a tariff or only an import license. In fact, in sectors such as agriculture, automobiles, and others, all of these barriers may exist. Thus, eliminating just one or even several may not guarantee meaningful market access.

#### Tariffs and Taxes

As is the case in most countries, the first line of trade barriers in China is the tariff. Only a few years ago, Chinese tariffs in many sectors were prohibitive, but China has lowered its tariffs substantially. Since 1992, China has lowered its tariffs from 42 percent to 17 percent.<sup>20</sup> This average remains considerably above the low single digit

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<sup>19</sup> USITC, *Assessment of...*, pp. 2:14 – 2:24.

<sup>20</sup> Office of the United States Trade Representative, *1995 National Trade Estimate Report on Foreign Trade Barriers* (Washington, DC: Government Printing Office, 1995) pp. 49-50 and Office of the United

tariff rates of developed countries, like the United States and Japan, and is closer to being in line with developing countries. In some areas, such as highly prized manufacturing sectors and agriculture, tariffs remain prohibitive. For example, current tariffs on automobiles range to over 100 percent.<sup>21</sup>

Chinese customs officials have or at least take considerable leeway in applying import taxes. The level of tax applied can thus vary from port to port and actual tariffs collected are well below expected levels, given posted rates.<sup>22</sup> Reportedly, bribery and corruption seem to play a role in determining the application of tariffs. Central government authorities have attempted to address this concern, but it is a deep-seated problem.<sup>23</sup>

In addition to tariffs, China applies a 13 to 17 percent value added tax to imports at the border. The tax is neutral on its face – applied equally to imports and domestic production - but given the weaknesses in China’s tax collection system domestic products often avoid the tax.<sup>24</sup> This is another notable example of the impact of China’s weak rule of law on foreign trade and commerce.

In its WTO accession agreement with the United States, China has committed to further tariff reductions. Overall average tariffs are scheduled to fall from the current 17

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States Trade Representative, *2000 National Trade Estimate Report on Foreign Trade Barriers* (Washington, DC: Government Printing Office, 2000) pp. 43.

<sup>21</sup> USTR, *2000 National Trade Estimate*, pp. 44.

<sup>22</sup> USITC, *Assessment of...*, pp 2:20.

<sup>23</sup> Daniel Rosen, *Behind the Open Door: Foreign Enterprises in the Chinese Marketplace* (Washington, DC: Institute for International Economics, 1999) pp. 218.

<sup>24</sup> USTR, *2000 National Trade Estimate*, pp. 44.

percent to 14 percent. On some products, tariff cuts will be even more dramatic. Auto tariffs – now ranging over 100 percent – are scheduled to fall to 25 percent, though this level of tariff may still restrict import of autos. The Clinton administration has made special mention of tariff cuts on agricultural products, auto parts, and various forest products.<sup>25</sup>

### Non-Tariff Barriers

China maintains a variety of non-tariff barriers, including quotas, tariff rate quotas, and import licenses. These are often used to protect the agricultural sector and various prized manufacturing sectors. These import controls are administered by the central government and are generally set through consultations with various Chinese ministries charged with managing relevant sectors of the economy and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), China's international trade ministry, which aim to determine "demand" for imports. This consultation process demonstrates the considerable degree of central economic planning still present in the Chinese economy.

As with other areas, there has been substantial liberalization of non-tariff barriers, though quotas still limit some 40 categories of imports.<sup>26</sup> The U.S. experience with Chinese import licenses demonstrates a frequent trade problem with China in the 1990s. In a 1992 agreement with the United States (which is discussed more extensively in the next section), China agreed, among other things, to eliminate import licenses. Shortly

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<sup>25</sup> China Trade Relations Working Group, *Summary of U.S.-China Bilateral WTO Agreement*, February 2, 2000. Available at [www.chinapntr.gov](http://www.chinapntr.gov).

thereafter, however, China announced a new series of import registration requirements that covered many of the same products. Functionally, import registration requirements are identical to import licenses; the similarity is so marked that the Clinton administration did not distinguish between the two import controls in its latest listing of foreign trade barriers.<sup>27</sup>

The WTO would seem to prohibit the vast majority of these non-tariff measures, with the exception of some in the agriculture sector. Thus, upon accession to the WTO, China will be obligated to terminate most import quotas, import licenses, and import registration requirements.<sup>28</sup>

### Trading Rights

Perhaps the most sweeping Chinese restriction on trade comes through the allocation of trading rights. By restricting the entities that have trading rights – the right to engage directly in importing and exporting – most companies, Chinese and foreign, are kept out of foreign trade. To engage in trade, companies must get a special dispensation from the government, usually limited to specific products for a specific time, or engage a company with more general trading rights, which often is subject to government direction.<sup>29</sup>

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<sup>26</sup> USTR, *2000 National Trade Estimate*, pp. 45.

<sup>27</sup> USTR, *2000 National Trade Estimate*, pp. 45.

<sup>28</sup> China Trade Relations Working Group, *Summary of U.S.-China Bilateral WTO Agreement*.

<sup>29</sup> World Bank, *China: Foreign Trade Reform* (Washington, DC: World Bank Group, 1994) pp. 64.

In 1999, MOFTEC announced new regulations that allowed a range of Chinese firms to apply for trading rights. It is reportedly working on further regulations to grant a range of foreign firms trading rights, subject to various restrictions.<sup>30</sup>

Here again, WTO membership would require China to undertake reform. In its bilateral WTO accession agreement with the United States, China committed to phase out trading right restrictions and eliminate restrictions on distribution in China within three years from the date of accession.<sup>31</sup>

### Restrictive Ministry Policies

The Chinese government ministries responsible for each sector of the economy administer many of the non-tariff barriers just listed. In addition to the easily classifiable barriers that these ministries promulgate and operate, they also maintain policies with the explicit aim of restricting imports.

The Ministry of Information Industries (MII), which regulates telecommunications and Internet services, was one of the most visible opponents of China's WTO membership. Not surprisingly, it imposes numerous restrictions on the operations of foreign companies, some with the stated objective of enhancing state security and some with simple protectionist aims. For example, in 1998 MII circulated an

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<sup>30</sup> In listing its basic policies, MOFTEC makes reference to the 1999 reforms and lists as its second policy goal, "Stick[ing] to the policy of deepening the reform of the foreign trade and economic cooperation regime and, with the momentum of the reform, promot[ing] the sustained, rapid and healthy development of the foreign trade and economic cooperation sector." Available at [www.moftec.gov.cn](http://www.moftec.gov.cn).

<sup>31</sup> China Trade Relations Working Group, *Summary of U.S.-China Bilateral WTO Agreement*.

internal document instructing telecommunication companies operating in China to source components from Chinese companies.<sup>32</sup>

China has also sanctioned state plans that explicitly call for import substitution – replacing imports with domestic production – in the automobile and pharmaceutical sectors.<sup>33</sup> A similar provision is widely rumored to be contained in the still unreleased plan for the electronics industry. In 1998, China also issued regulations directing power production facilities to use Chinese made equipment.<sup>34</sup> There are numerous similar examples of China’s Agriculture Ministry working to discourage imports and promote domestic production.<sup>35</sup>

Many of these efforts are inconsistent with the WTO and also directly violate commitments contained in the 1992 U.S.-China agreement on market access.<sup>36</sup> Policies like this could well prove the most vexing trade barriers to address in China. Many Chinese ministries have made no secret of their opposition to the WTO and obviously see their mission to promote Chinese industry regardless of commitments made in the WTO

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<sup>32</sup> “Ministry Profile – Information Overlord,” *China Economic Review*, October 23, 1998 and “China’s Path To Gain Back Telecom Market – Buy ‘Made in China’ and No New Foreign GSM Projects,” *ChinaOnline*, November 10, 1998.

<sup>33</sup> USTR, *2000 National Trade Estimate*, pp. 47.

<sup>34</sup> Dexter Roberts, “‘A Big Black Hole’ For Foreign Investors,” *Business Week*, June 22, 1998, pp. 56 and P.T. Bangsberg, “China National Power Plans Infrastructure Upgrade,” *Journal of Commerce*, December 3, 1998, pp. 9A.

<sup>35</sup> This includes the imposition of safety licensing requirements that lack transparency, a lack of national treatment for imported agricultural products and an outright ban on imports of certain products. See USTR, *2000 National Trade Estimate*, pp. 48.

<sup>36</sup> In the 1992 Market Access Memorandum of Understanding (MOU), China committed to opening its market in four ways: 1) Making its trade regime more transparent; 2) Reducing the number of products subject to import licenses; 3) Paring back quotas, tariffs and other import controls; 4) Eliminating arbitrary and unscientific standards for imported products and reducing onerous certification requirements. Since its enactment, every edition of the USTR’s *National Trade Estimate* has documented a number of Chinese violations of this agreement. See Mastel, *The Rise of the Chinese Economy*, pp. 91-95.

or elsewhere. It is certainly possible to attack public policies that contravene the WTO, such as published agency directives, but it is much more difficult to attack informal agency direction and other forms of *sub rosa* intervention because they generate no paper trail.

Since the foreign companies subject to these discriminatory policies must continue to deal with the offending ministry, they may be unwilling to raise their complaints for fear of drawing the ire of bureaucrats. Even if they do come forward, it may prove difficult to even establish the existence of the policy. Beyond that, China's weak rule of law is well known. Even if the central government supports compliance with WTO commitments and openness to imports, it may have difficulty changing various ministry policies.

Similar, *sub rosa* protectionism has been cited as the core of ongoing trade problems with Japan.<sup>37</sup> As was demonstrated in the recent case on photographic film, the United States has had difficulty establishing this type of problem to the satisfaction of the WTO.<sup>38</sup> For all its problems, however, Japan has a much greater tradition of transparency than China. Over time, constantly shifting ministry policies aimed at restricting imports promise to be one of the most serious challenges for the United States and the WTO in efforts to open the Chinese market.

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<sup>37</sup> In describing this situation, the *2000 National Trade Estimate* stated, "Japanese regulators view their role not simply as neutral arbiters of a legal rule-based system, but as active players in guiding the respective industries under their purview. The close government-industry relationship in Japan often works to the disadvantage of foreign firms trying to enter or participate in the Japanese market because the relationship favors domestic firms" (pp. 229).

<sup>38</sup> World Trade Organization, *Report of the Panel: Japan – Measures Affecting Consumer Photographic Film and Paper*, Document WT/DS44/R, March 31, 1998.

## Government Procurement

One particularly difficult example of what might be called ministry and agency bias involves government procurement. Many major projects in China are government projects, thus the government procurement market in China is potentially enormous. There is, however, no tradition of open, transparent bidding processes in China.<sup>39</sup> Given close connections between the agency undertaking the procurement and various Chinese State Owned Enterprises (SOEs) and related entities also involved in the bidding process, the potential for corruption, bid-rigging, and similar measures to exclude foreign companies generally or punish particular foreign companies is considerable. Many foreign bidders have also complained of demands for transfer of technology and Chinese content requirements being attached to various government procurement projects.<sup>40</sup>

In the 1992 agreement, China agreed to make the entire bidding process public, but a number of Chinese ministries have yet to comply.<sup>41</sup>

China is reportedly working on a WTO consistent law on government procurement, but beyond that statement no specific information has been made public.<sup>42</sup>

## Investment Restrictions

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<sup>39</sup> Mastel, *The Rise of the Chinese Economy*, pp. 110-111.

<sup>40</sup> Rosen, *Beyond the Open Door*, pp. 71-72.

<sup>41</sup> USTR, *2000 National Trade Estimate*, pp. 49.

<sup>42</sup> The law is expected by 2003. See "Government Buying at Issue," *Xinhua News Agency*, December 21, 1999.

China has generally aggressively sought foreign investment over the last twenty years. As a result of that policy, Chinese restrictions and barriers to investment are generally much lower than those on imports. China has, however, been increasingly suspect of foreign investment in sectors where a national security impact was seen by Chinese authorities, such as telecommunications.<sup>43</sup> Further, in other sectors, such as automobiles, China has reportedly increased demands on foreign companies investing in China to transfer increasing amounts of technology to China.<sup>44</sup>

Other western companies have reported pressure to shift from exporting to China to producing in China. A leading U.S. producer of fiber optic cable, Corning, has complained of Chinese demands to transfer production facilities to China instead of manufacturing in North Carolina. Citing production rationalization and technology transfer concerns, Corning has resisted Chinese entreaties, but pressure reportedly continues to be applied by Chinese authorities.<sup>45</sup>

Many of these Chinese policies, particularly the demands for technology transfer, violate commitments made in China's WTO accession agreement with the United States as well as the 1992 bilateral understanding.<sup>46</sup> These commitments are particularly difficult to enforce, however, because it is rare that a company is willing to make its complaints public, as Corning has done. Some companies have even openly offered

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<sup>43</sup> USTR, *2000 National Trade Estimate*, pp. 56.

<sup>44</sup> See Carter Dougherty, "WTO Pact May Guard Trade Secrets," *The Washington Times*, March 28, 2000, pp. B7.

<sup>45</sup> William Roberts, "White House Fails to Enforce Trade Laws, Senators Say," *Journal of Commerce*, February 24, 1999, pp. 3A.

<sup>46</sup> See Mastel, *The Rise of the Chinese Economy*, pp. 91-95 and China Trade Relations Working Group, *Summary of U.S.-China Bilateral WTO Agreement*.

technology transfer as an inducement to Chinese authorities.<sup>47</sup> Further, even if Chinese ministries were forced to publicly terminate policies of demanding investment and technology transfer in return for permission to operate in China, these factors could still figure into the private decisions of Chinese bureaucrats and agencies, making this a very difficult problem to police.

### Export Subsidies

China announced formal abolition of export subsidies in 1991. Nonetheless, exports of a number of agricultural products, including cotton and corn, continue to benefit from direct export subsidies. Exports of other products receive indirect export subsidies through preferential rates on energy or labor.<sup>48</sup> Most if not all of these subsidies are directly prohibited by the WTO.<sup>49</sup>

A related issue arises from China's increasing rebates of taxes paid on exports. Properly done, tax rebates on exports, such as Europe's rebating of its VAT, are WTO consistent. China, however, has repeatedly raised its export tax rebates since its exporters began to feel the impact of the 1997 Asian economic crisis.<sup>50</sup> Given China's poor system of tax collection and the limited documentation it has released on this program, it is reasonable to question if these are legitimate tax rebates or merely export subsidies by another name.

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<sup>47</sup> See Dougherty, "WTO Pact May Guard Trade Secrets," and Terry McCarthy, "The China Drive," *Time*, May 22, 2000, pp. 50.

<sup>48</sup> USTR, *2000 National Trade Estimate*, pp. 49.

<sup>49</sup> See World Trade Organization, "Agreement on Subsidies and Countervailing Measures," *Agreement Establishing the World Trade Organization*, April 15, 1994, Annex I. Available at [www.wto.org](http://www.wto.org).

<sup>50</sup> "VAT Refund Incentive," *China Economic Review*, October 31, 1999, pp. 16; and "VAT Law Needs Revision to Spur Investment," *China Daily*, May 14, 2000.

## Agriculture Restrictions

As is the case in many countries, China pays particular attention to protecting its agricultural sector. Many of the high tariffs and non-tariff barriers noted in previous sectors are applied with great frequency in the agricultural sector. The United States has had long-standing disputes with China over various restrictions on imports of agricultural products, such as wheat and meat; China alleges that these restrictions are legitimate sanitary and phytosanitary restrictions and the United States believes they are but another example of agricultural protectionism.<sup>51</sup>

WTO discipline is not as complete in the agricultural sector as in other traded goods sectors, so many of the restrictions may not be entirely prohibited – though they would be liberalized under the WTO. In the accession process, the United States attempted to specifically address certain bilateral problems regarding citrus fruits, meat, and wheat<sup>52</sup>. Commitments on these topics were made during Premier Zhu’s U.S. visit in the spring of 1999 and were to be immediately implemented. Reportedly, implementation began in the fall of 1999, although new exports in these sectors are still quite limited.<sup>53</sup>

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<sup>51</sup> Testimony of Charlene Barshefsky Before the House Committee on Ways and Means, “U.S.-Bilateral Trade Agreement and the Accession of China to the World Trade Organization,” February 16, 2000. Ambassador Barshefsky referred to many of these standards as “unscientific”.

<sup>52</sup> *Agreement on U.S.-China Agricultural Cooperation*, April 10, 1999. Available at [www.ustr.gov](http://www.ustr.gov).

<sup>53</sup> See Office of the United States Trade Representative, “China Opens Its Market to Imports of U.S. Citrus, Meat, and Wheat,” Press Release 00-20, March 22, 2000 and Ted Plafker, “U.S. Citrus Headed for Sale in China – Bureaucratic Foul-Up Meant Weeks of Delay,” *The Washington Post*, May 16, 2000, pp. E3.

In theory, China's market for agricultural products is substantial and China has imported substantial amounts of agricultural commodities, such as wheat, in the past. On its face, however, WTO membership would do little to curb China's domestic agriculture programs and, thus, would have limited short-term impact upon China's agricultural imports.<sup>54</sup> Comments made by China's chief trade negotiator to Chinese farmers would seem to support this conclusion.<sup>55</sup>

### Services

Historically, China's market for services has been even more restricted than its market for goods. Nonetheless, western providers of financial services, telecommunication services, and Internet services have actively sought to establish operations in China. To this point, they have had limited impact; a few insurance providers have won the right to limited operations in restricted areas, but the Chinese market is largely closed.<sup>56</sup>

As noted in previous sections, China's WTO accession agreement contained commitments to substantial new market access for western service providers, including

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<sup>54</sup> For a summary of China's current agricultural policy, see United States Department of Agriculture, *People's Republic of China Food and Agricultural Import Regulations and Standards* (Washington, DC: USDA, 1999).

<sup>55</sup> In an article to quell concern over the accession agreement with the US, Long Yongtu is quoted as saying, "The Sino-US agricultural cooperative agreement signed this time has triggered extensive concerns...This is absolutely wrong. Commitment is just an opportunity for market accession in terms of theory. We may, or may not import such an amount..." Quote taken from an article entitled, "Long Yongtu: China's Entry Into the WTO is Absolutely Not a Losing Proposition," carried by the Chinese newspaper *Guangzhou Ribao* on January 6, 2000. Cited in "Chief Negotiator Cited on Sectoral Impacts of WTO Entry," *BBC Summary of World Broadcasts*, January 12, 2000.

<sup>56</sup> See Rosen, *Behind the Open Door*, pp. 79 and "China – Insurance Market to Open Wider," *China Daily*, November 19, 1999.

the sectors just listed.<sup>57</sup> Time will tell how many concrete opportunities result from these commitments.

### Other Barriers

The foregoing discussion has listed the most important trade barriers maintained by China against imports, but there are others. For example, there are various standards and testing barriers, which restrict or impose significant burdens upon exports to the Chinese market.<sup>58</sup> Most of these restrictions would appear inconsistent with WTO provisions.

China's well-publicized failure to protect intellectual property has also been a *de facto* barrier to operating in China for many western companies that rely upon trademarks, patents, or copyrights. Fear that important intellectual property will be pirated keeps some western companies from operating in China and costs others substantial lost revenues.<sup>59</sup> As described in the next section, China has committed, both in a series of bilateral agreements and through the WTO, to improve protection of intellectual property.

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<sup>57</sup> China Trade Relations Working Group, *Summary of U.S.-China Bilateral WTO Agreement*.

<sup>58</sup> USTR, *2000 National Trade Estimate*, pp. 47-48.

<sup>59</sup> International Intellectual Property Alliance (IIPA), *2000 Special 301 Report: People's Republic of China*, February 2000, pp. 26.

## TRADE AGREEMENT COMPLIANCE PROBLEMS

In the last decade, the United States and China have negotiated a number of bilateral trade agreements. They have covered topics ranging from protection of intellectual property to imports of goods made with prison labor. In addition to highlighting the sectors where the United States and China have particularly intense differences, these agreements indicate the magnitude of the compliance problem likely to be faced with regard to the WTO in coming years.

### Intellectual Property Protection

U.S.-China intellectual property disputes began more than a decade ago and are deeply seated. Under Chairman Mao, China was not positively disposed to the concept of protecting intellectual property, such as patented and copyrighted material. In addition to Marxism-related problems, there is a cultural problem. Many Chinese still refer to an adage that declares stealing a book to be a justifiable crime.

After some years of low-level wrangling on the issue, the United States began pressing China hard to improve intellectual property protection in 1991 and 1992. The ultimate result of this was an agreement between the United States and China, which obligated China to strengthen its copyright, patent, and trademark laws. As a result of this agreement, Chinese intellectual property laws were raised to a level superior to most developing countries and, although there were remaining problems, on a par with developed countries.<sup>60</sup>

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<sup>60</sup> Greg Mastel, *American Trade Laws After the Uruguay Round* (Armonk, NY: M.E. Sharpe, 1996) pp. 44-48.

Unfortunately, these legal changes did little to stop intellectual property piracy on the ground. In fact, intellectual property piracy of computer programs, music recordings, and films dramatically expanded. In 1994, the United States challenged China again over enforcement. On February 26, 1995 -- the last day before more than \$1 billion in trade sanctions for intellectual property were to be imposed, China agreed to a new enforcement regime.<sup>61</sup>

This 1995 understanding had almost no impact on the rising tide of piracy of intellectual property. There were increasing reports that Chinese manufacturers were actually exporting pirated music and computer programs to markets as far away as Canada. The involvement of the relatives of senior Chinese leaders and the People's Liberation Army was also widely rumored. The United States again challenged China over enforcement of intellectual property statutes. Once again under the imminent threat of sanctions in 1996, China agreed to improve its enforcement regime. This understanding included specific checks to ensure enforcement in terms of police raids on pirate factories and related measures.<sup>62</sup>

The success of the 1996 agreement has been debated. Clinton administration officials argue that the Chinese have halted the most onerous problem, the export of

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<sup>61</sup> Mastel, *American Trade Laws After the Uruguay Round*, pp. 44-48.

<sup>62</sup> Office of the United States Trade Representative, *Chinese Implementation of the 1995 IPR Enforcement Agreement: Fact Sheet*, June 17, 1996.

pirated CDs from China.<sup>63</sup> This may be true, but it is hardly the only problem the administration cited during negotiations with China; in fact, the administration went to some lengths to demonstrate that the problem of piracy impacted many industries through many kinds of violations.<sup>64</sup> U.S. intellectual property companies are, by and large, not pressing for new trade actions against China. In its most recent annual assessment of the piracy problem in China, the International Intellectual Property Alliance (IIPA) reports that piracy rates for most categories of copyrighted intellectual property remain over 90 percent and that the total economic cost of piracy to the United States has risen since 1995.<sup>65</sup>

Unquestionably, the United States has devoted considerable time and effort to enforcing intellectual property understandings with China. These efforts can show some results in terms of pirate plants shut down and arrests made, but intellectual property piracy is still generally regarded as an enormous problem in China.

The WTO contains provisions to protect intellectual property.<sup>66</sup> In fact, WTO requirements closely parallel those China agreed to in bilateral negotiations with the United States. As is discussed in greater detail below, China's WTO membership will

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<sup>63</sup> Testimony of Charlene Barshefsky Before the Senate Finance Committee, "Implications of the Seattle Ministerial for US Trade Policy," February 10, 2000.

<sup>64</sup> Seth Faison, "U.S. and China Agree on Pact to Fight Piracy," *The New York Times*, June 18, 1996, pp. A1; Sheila Tefft, "U.S.-China Deal on Piracy Warms Up Ties – For Now," *The Christian Science Monitor*, June 18, 1996; and Joe Studwell, "Piracy Pact: Tough or Toothless?" *Journal of Commerce*, June 19, 1996, pp. 1A.

<sup>65</sup> IIPA, *2000 Special 301 Report*, pp. 27.

<sup>66</sup> World Trade Organization, "Agreement on Trade-Related Aspect of Intellectual Property Rights," *Agreement Establishing the World Trade Organization*, April 15, 1994. Available at [www.wto.org](http://www.wto.org).

change the course on which U.S.-China disputes over intellectual property proceed, but the conflict seems likely to continue for some years.

#### Market Access

The United States concluded a sweeping market access agreement with China in 1992. In this agreement, China agreed to lower tariffs, eliminate import licenses, make all trade regulations transparent, and adopt a host of other trade liberalizing initiatives. In total, this agreement, which was reached under the threat of U.S. trade sanctions, obligated China to substantial trade liberalization.<sup>67</sup>

Certainly, China has implemented some of these provisions. The National Trade Estimate, however, has noted a number of violations. China agreed to eliminate import licenses, but for a large number of products it introduced remarkably similar import registration requirements.<sup>68</sup> China agreed to end import substitution policies, but has formally endorsed such requirements with regard to automobiles, pharmaceuticals, and other products in the intervening years.<sup>69</sup> Despite a commitment to make all trade regulations public, some – particularly some involving government procurement, are still not public.<sup>70</sup> Unfortunately, there are a number of similar problems, on matters such as power generating equipment.<sup>71</sup>

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<sup>67</sup> Mastel, *American Trade Laws After the Uruguay Round*, pp. 21-23.

<sup>68</sup> USTR, *2000 National Trade Estimate*, pp. 45.

<sup>69</sup> USTR, *2000 National Trade Estimate*, pp. 47.

<sup>70</sup> USTR, *2000 National Trade Estimate*, pp. 46.

<sup>71</sup> USTR, *2000 National Trade Estimate*, pp. 46-57.

The United States has never formally challenged China over these violations of the 1992 agreement. Action was contemplated under Section 301 in 1998, but subsequently rejected. Reportedly, some in the administration preferred to pursue these issues in the context of WTO accession.<sup>72</sup>

Unfortunately, WTO membership is unlikely to sweep these problems away. Many of the same issues are likely to be confronted in WTO disputes with China.

### Other Agreements

There have been similar compliance problems with other agreements with China involving topics such as textile imports under the Multi Fiber Agreement<sup>73</sup> and the agreement on imports manufactured by Prison Labor.<sup>74</sup>

The agreement compliance problems with China are so consistent as to warrant further consideration. It is often noted that China has a weak rule of law; this means, as a leading Chinese official has put it, that “China is a county of strong leaders, not strong laws.”<sup>75</sup> This is a particular problem when it comes to trade agreements because they rely upon the rule of law for enforcement.

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<sup>72</sup> Bruce Stokes, “Almost Now-or-Never Time,” *The National Journal*, Vol. 30 No. 50, December 12, 1998.

<sup>73</sup> See Office of the United States Trade Representative, “Triple Charges Assessed on Chinese Textile Transshipments,” Press Release 98-45, May 5, 1998 and U.S. Customs Service, *Textile Transshipment Report*.

<sup>74</sup> See U.S. Department of State, *China Country Report on Human Rights Practices for 1998* (Washington, DC: U.S. Department of State, February 26, 1999) pp. 26-28 and U.S. Department of State, “China,” *1999 Country Reports on Human Rights Practices* (Washington, DC: U.S. Department of State, February 25, 2000) pp. 56-57.

China has all of the standard incentives to cheat on trade agreements to appease powerful constituencies and achieve economic gains, but it has the additional problem that there is no reliable legal system to rein in rogue agencies or provinces. The result is that cheating on trade agreements is an example of a deep systemic problem. This results in clear shortcomings in China's record of complying with its trade commitments.

Some have argued that other countries have had as poor a record as China in fulfilling trade agreements.<sup>76</sup> It is certainly true that the United States has had serious trade agreement compliance problems with other countries, notably Japan<sup>77</sup> and South Korea<sup>78</sup>. Recently, the United States has had a great deal of difficulty getting the European Union to fulfill the trade commitments it has made regarding agriculture in the context of the WTO.<sup>79</sup> Nonetheless, the trade compliance problems with these countries do not appear as significant and consistent as China's. In any event, it is not clear why Japan's trade agreement violations justify ignoring China's violations – especially when they materially impact U.S. trade prospects in China.

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<sup>75</sup> Willy Wo-Lap Lam, "Qiao's Bid for the Throne," *South China Morning Post*, April 13, 1996, pp. 21.

<sup>76</sup> Rosen, "China and the World Trade Organization".

<sup>77</sup> See Edward J. Lincoln, *Troubled Times: US-Japan Trade Relations In the 1990s* (Washington, DC: Brookings Institution Press, 1999) for an overview of these difficulties.

<sup>78</sup> Office of the United States Trade Representative, *1998 National Trade Estimate Report on Foreign Trade Barriers* (Washington, DC: Government Printing Office, 1998) pp. 259-261.

<sup>79</sup> "A Not-So-Perfect Market," *The Economist*, March 25, 2000 and Guy de Jonquieres, "US and EU Head for Sanctions Clash," *Financial Times*, May 8, 2000, pp. 12.

## THE WORLD TRADE ORGANIZATION AND CHINA

The process of WTO accession has several stages. When a country expresses an interest in WTO accession, a working group is formed to consider the application and work with the applicant. Normally, countries that have a major trading interest with the applicant join the working group. The applicant must complete bilateral market access negotiations with each of the members of the working group; normally, these negotiations focus on various market access matters of specific interest. Once the bilateral negotiations are complete, they are joined together in a single agreement; negotiations on various issues of more general interest, such as the application of WTO provisions on government procurement or subsidies, are completed and joined into a WTO accession protocol. This protocol then goes to the WTO Council for final approval.<sup>80</sup>

### China's WTO Accession

China now appears to be nearing the end of its accession process. China completed bilateral WTO accession negotiations with the United States in November of 1999.<sup>81</sup> Since then, China has completed bilateral accession agreements with most other working group members.<sup>82</sup>

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<sup>80</sup> John H. Jackson, *The World Trade Organization: Constitution and Jurisprudence* (London: Royal Institute of International Affairs, 1998) pp. 47-51.

<sup>81</sup> Office of the United States Trade Representative, "US, China Sign Historic Trade Agreement," Press Release 99-95, November 15, 1999.

<sup>82</sup> See John Leicester, "WTO: China Very Close to Joining," *AP Online*, February 18, 2000 and "China to Start Intensive Talks on WTO Accession," *Japan Economic Newswire*, March 14, 2000.

Recently, China struck a bilateral accession agreement with the European Union.<sup>83</sup> Several other bilateral negotiations remain to be completed.

Once the bilateral talks are completed, the working group will need to address some important matters with China, such as the application of rules on industrial subsidies and oversight, before the accession protocol can be completed. Some members of the group have expressed the hope that this process might be completed over the summer of 2000. This would clear the way for China to actually complete the WTO accession process late in 2000.<sup>84</sup>

#### Dispute Settlement Concerns

As was noted in the discussion of Chinese trade barriers, in joining the WTO China has committed to substantial reductions of many trade barriers. If implemented, these reductions promise to have a significant impact upon U.S. export opportunities in China. Many economic analyses have projected substantial increases in U.S. exports ranging from \$1 billion to \$10 billion as a result of WTO accession.<sup>85</sup>

Of course, all of these estimates assume implementation by China as well as stable macroeconomic conditions; as the discussion in the previous section made clear

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<sup>83</sup> Clay Chandler, "China, EU Sign Broad Trade Pact; Accord Opens Way for WTO Membership," *The Washington Post*, p.A1.

<sup>84</sup> Leicester, "WTO: China Very Close to Joining," and "China and the WTO: Dire Straits?" *The Economist*, March 25, 2000.

<sup>85</sup> USITC, *Assessment of...*, pp. xi-xvi and Hufbauer and Rosen, "American Access to China's Market," Appendix B.

implementation is problematic. A dramatic slowdown in Chinese growth or a Chinese devaluation could also dramatically impact export opportunities in China.

In the next few years, China could well be the focus of substantial WTO dispute settlement actions. This could pose a challenge for the WTO because it is a rule of law based organization, while China is not an entirely rule based country. Since trade policy in China is still often made informally by ministries -- sometimes without a clear paper trail - it may be difficult to document the existence of Chinese practices to the satisfaction of a WTO dispute settlement panel.<sup>86</sup>

Beyond that, as recent U.S.-European disputes on agriculture have demonstrated, winning WTO panels does not automatically mean that a country changes its offending trade policy – even in the face of trade retaliation.<sup>87</sup> It is possible to imagine China proving at least as difficult as Europe to deal with in connection with the WTO.

On the positive side, the WTO does hold the potential of bringing multilateral pressure to bear on China to win changes in Chinese trade policy. This may avoid some of the bilateral acrimony associated with past U.S.-China trade disputes.

On the other hand, China's WTO membership does effectively preclude the United States threatening to impose unilateral trade sanctions on China to settle trade

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<sup>86</sup> The U.S.-Japan dispute over photographic film demonstrates the limitations of the WTO in addressing problems when the nature of the underlying government practice is uncertain. It is certainly possible to imagine similar disputes with China in which the very existence of the questionable policy is in dispute.

disputes as the United States has done in connection with protection of intellectual property and market access.

In strongly pressing for the creation of the WTO, the United States has made the implicit policy judgment that WTO rule-based approaches to disputes are more promising than bilateral strong-arming. It is certainly true that bilateral threats have had decreasing utility with China in recent years. Only time will tell how successful the WTO dispute settlement process will be in making China's extensive list of trade concessions into reality.

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<sup>87</sup> Frances Williams, "WTO Raps US Over Banana Dispute Sanctions," *Financial Times*, March 16, 2000, pp. 12 and "Merry-Go-Round," *The Economist*, May 13, 2000.

## CONCLUSION

Despite recent steps to lower trade barriers, China remains a highly protected market. China maintains an array of barriers ranging from high tariffs to import registration requirements. Collectively, these policies are significant barriers to U.S. exports, particularly in the agricultural sector and other manufacturing sectors -- like electronics and automobiles -- in which China has pursued an aggressive industrial policy aimed at building Chinese industries.

Many observers have argued that the prospects for opening the Chinese market are brighter than those of opening the Japanese or South Korean market at a comparable stage of development. These observers rightly point out that China is much more open to foreign investment than Japan and Korea were. In fact, China has actively sought foreign direct investment as sources of western capital and technology. FDI has been a key element of China's development strategy. For their part, Japan and Korea have shunned foreign investment preferring to encourage the development of domestic companies, often behind trade barriers.

China's openness to investment, however, does not necessarily portend openness to imports. In fact, trade barriers in sectors such as automobiles have clearly been part of China's strategy to encourage foreign investment. Since, the Chinese market could not be accessed easily through exports, those western automakers that wanted a portion of the Chinese market were effectively forced to invest. Once in the market, many western

companies took a different view of Chinese trade barriers because now they also protected them from competition from outside China.<sup>88</sup>

The unstated assumption of many is that openness to foreign investment will eventually lead to openness to increased foreign trade. It is certainly true that some Chinese reformers would like to lower barriers to encourage increased competition and help China take the next step in development. It is, however, not clear that reforms already undertaken to encourage FDI will inevitably lead to lower trade barriers. In fact, China's increasing demands for domestic production and transfer of technology suggest that the opposite may be true, at least in some sectors.

Certainly, China's membership in the WTO is a positive sign. China has committed to an impressive set of market access commitments in order to gain membership. Of course, China's poor record of agreement compliance does raise questions, at least about the pace at which these opportunities are likely to materialize. There seems to be deep division within China on the wisdom of further economic opening; it is difficult to predict the ultimate internal resolution of this question. In the West, many view reformers as the stronger faction, but an economic recession or a military crisis could result in a dramatic reversal of their fortunes.

Further, even if – as seems likely – some current Chinese leaders are truly committed to reform, it is unclear if they will be able to force China's diverse collection of Ministries, SOEs, and provincial authorities to accept their mandate given China's

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<sup>88</sup> Rahul Jacob, "Racing Start for Buicks in China," *Financial Times*, April 27, 2000, pp. 15.

well-documented problems with the rule of law. Current U.S. efforts to assist China in building a rule of law and battle corruption through legal exchanges and other efforts are positive, but this seems an area where reform will need to be internally driven. There is substantial evidence that average Chinese desire a “cleaner” system, but corruption seems to be a reality that many in China, including many in leadership, are willing to tolerate. More than any other single issue, the lack of a reliable rule of law is the largest impediment to western companies seeking to operate in China.<sup>89</sup>

Ultimately, it is impossible to make reliable predictions about developments within a political system that is almost entirely closed. It is even harder to predict the outcome of various U.S. policy actions especially given the many unknowns, such as the attitude of the Chinese military, China’s growing nationalist sentiments, and the potential for China’s leaders to view accommodation as weakness. These issues are often considered mainly in the security context, but they have important application to economic issues. For example, might a flexible attitude in trade disputes be seen as evidence that reform is unnecessary? Could pushing too hard for reform inspire a nationalist backlash? Might an effort by the United States or the WTO to give China time to implement key provisions actually weaken the political arguments of China’s reformers?

Rather than being paralyzed by these uncertainties, a steady approach of pressing China to undertake promised trade reforms seems the wisest course. The United States should continue to press for reform both to improve trade opportunities within China and

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<sup>89</sup> Greg Mastel, *The Rise of the Chinese Economy* (Armonk, N.Y.: M.E. Sharpe, 1997) pp. 81-99.

to encourage reformers within China. Consistency seems the course least likely to be misunderstood and least likely to have unintended adverse consequences. Only time will tell the true intentions and ability of China's government to implement economic reform and the ability of the WTO to steer China in a positive direction.

In the meantime, U.S. imports from China are likely to continue to grow. This means that a large continuing U.S trade deficit with China is a virtual certainty. In the coming decade, China is likely to displace Japan as the country with which the United States maintains the largest bilateral trade deficit. Regardless of one's views on the trade deficit, its existence virtually guarantees that trade will remain an important tension in U.S.-China relations.