

# CRS Report for Congress

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## China and the World Trade Organization

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

### Summary

China has sought over the past several years to become a member of the World Trade Organization (WTO), the international agency that administers multilateral trade rules. China's WTO membership (as well as that of Taiwan's) was formally approved at the WTO Ministerial Conference in Doha, Qatar in November 2001. On December 11, 2001, China officially became a WTO member. WTO membership will require China 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. 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 will require China to change many laws, institutions, and policies to bring them into conformity with international trade rules.

### China's Interest in WTO Membership

China made its accession to the WTO a major priority for a number of reasons. First, it would represent international recognition of China's growing economic power. Second, it would enable China to play a major role in the development of new international rules on trade in the WTO. Third, it would give China access to the dispute resolution process in the WTO, reducing the threat of unilaterally imposed restrictions on Chinese exports. Fourth, it would make it easier for reformers in China to push for liberalization policies if they could argue that such steps are necessary to fulfill China's international obligations. 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.

## 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.<sup>1</sup> 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

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<sup>1</sup> 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.<sup>2</sup> 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

It has now been over a year since China joined the WTO. On December 11, 2002, the USTR released its first annual China WTO compliance report. 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. China's compliance with its WTO obligations has often been 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

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<sup>2</sup> 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.

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. U.S. officials stated that the regulation “should remove the threat of an interruption of U.S. soybean sales to China.” 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 the WTO for resolution.
- **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. For example, under the WTO accession agreement, China’s TRQ for cotton in 2002 was 818,500 tons. In June 2002, China announced that the TRQ would be distributed as follows: 500,000 tons for processing trade, 270,000 tons for state-owned mills, and 48,500 tons for private mills. 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.
- **Tariffs.** China has been given relatively high marks for its tariff reductions. However, U.S. officials have charged that China has failed to fully comply with its commitment to eliminate tariffs for all products covered under the WTO’s Information Technology Agreement (ITA). Instead, China has extended zero tariffs only to producers in China that import ITA products in the manufacture of items for export.
- **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, local content requirements, and auto financing).
- **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 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 accession to the WTO, and the U.S. extension of PNTR status to China, will likely have important ramifications for U.S.-China economic relations. First, Congress will no longer vote annually on China's trade status, which could help bring greater stability and predictability to the trade relationship. Second, the United States (as well as China) will be able to use the WTO dispute resolution process to resolve trade disputes, rather than relying on unilateral threats of trade sanctions. Third, subjecting China's trade regime to multilateral rules means that the United States will no longer have to "go it alone" in trying to get China to open its markets; other WTO members would have an equally strong stake in ensuring China's compliance with its WTO commitments. Finally, China's accession to the WTO will likely improve the business climate in China, leading to greater trade and investment opportunities for U.S. firms. A sizable increase in U.S. exports to China would help reduce tensions over trade issues.

However, many analysts have raised concern over the ability and willingness of the Chinese government to fully implement its WTO commitments. Corruption and local protectionism are rampant in China, and gaining the cooperation of local officials and government bureaucrats that oversee various affected industries to implement WTO-consistent rules could prove difficult in the short run. Additionally, economic reforms required under WTO commitments could lead to significant short-term employment disruptions in China, especially among farmers and employees of inefficient state-owned enterprises. Some analysts warn that such disruptions might erode the government's determination to fully implement its WTO commitments, especially if it fears social stability is threatened.

U.S. firms that export to, or invest in, China are deeply interested in ensuring that China complies with its WTO commitments to remove discriminatory trade and investment restrictions and practices. Their concerns focus largely on development and implementation of China's plans to bring its trade regime in compliance with WTO rules. U.S. firms want to make sure that reforms are made as soon as possible and are enforced uniformly at the central, regional, and local government levels. They also want to be able to review proposed rules, laws, and standards and to have access to Chinese lawmakers and regulators in order to submit proposed changes (within a reasonable time period) before they go into effect. They want to ensure that texts of all new laws, regulations, and standards are made publically available, and that all such changes are written in a manner that is clear, consistent, and imposes no unreasonable burdens to U.S. firms. And finally, they want to ensure that the spirit of China's WTO accession agreement is achieved, so that the removal of trade and investment barriers specified under the WTO agreement actually leads to new trade and investment opportunities and is not undermined by the issuance of new restrictive rules, standards, or policies that in effect replace one barrier with another.

Congress will likely press the Bush Administration to ensure China's trade compliance with its WTO commitments. If U.S. exports fail to increase significantly, and the USTR's report finds serious deficiencies with China's compliance, Congress may press the Administration to file numerous dispute resolution cases against China in the WTO.