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ENTER THE DRAGON: China's Accession to the WTO

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Regarding certain Commodities heretofore Contraband. The restrictions affecting trade in Opium ... are relaxed under the following conditions: - 1. - Opium will henceforth pay thirty taels per picul Import Duty.

Rule 5, Treaty of Tientsin (1858)¹

The Government of China now agrees that it will establish a Patent Office. After this office has been established and special laws with regard to inventions have been adopted, it will thereupon ... issue certificates of protection ... to citizens of the United States on all their patents issued by the United States...

Article X, Commercial Treaty (1903)²

Introduction

Since the first contacts by sea nearly five hundred years ago, China's experience with trade relations with the European powers and subsequently the United States and Japan has not, on balance, been a happy one. The lessons of history weigh heavily on the current Chinese leadership - remember that the last vestiges of the *Unequal Treaties* imposed on China in the 19th and 20th centuries were only removed with the return of Hong Kong and Macau to Chinese sovereignty in 1997 and 1999 respectively (Hobbs and Kerr, 2000). Since the opening of trade relations, China's trade policy has exhibited violent swings between xenophobic attempts at autarky and relatively open periods when trade and other forms of international commerce were seen as a means to modernise the economy. While such radical changes in trade policy are not unexpected in developing countries (Kerr and Anderson, 1991), nowhere have the changes been so pronounced as in China.

After almost thirty years of development based on self-reliance and command during the Maoist era, China has entered into a period of increasing openness over the past two decades. Once again, trade and foreign investment are seen as a means of modernising the Chinese economy; they are not, however, perceived as desirable (welfare enhancing) in their own right. Chinese trade policy is simply an adjunct to overall development policy. While the Chinese leadership has abandoned formal economic planning and allocation by command, it has not embraced allocation by markets preferring, rather, the continually evolving and indefinable official policy of *market socialism*. The government remains far more interventionist than is the case in modern market economies. Further, a considerable portion of the economy remains under state ownership and control. While the Chinese government would probably like to divest itself of many of the remaining state enterprises, they are inefficient, unprofitable and overstaffed. The government fears the social consequences that would arise from market discipline being applied to these enterprises, particularly the widespread unemployment that would be one result.

The state enterprise sector of the Chinese economy, hence, remains large. Allocation among enterprises in the state enterprise sector and between the state enterprise sector and the private sector in China continue to be made on the basis of command and fiat rather than market prices, although less and less is directly controlled by the central government. This means that prices do not represent the opportunity cost of resources. Further, the lessening of control from the centre has meant that local officials (often-Communist Party members) and managers of state enterprises are able to use their control of business permits and resources for personal gain. This *licensing economy* is the basis of Chinese corruption and, because so many Party members have a vested interest in it, will be hard to reform (Kerr and MacKay, 1997). Privatisation and the removal of bureaucratic controls on business activity threatens the livelihood of those officials that currently have those allocative rights.

Thus, China's economy remains in a grey area between command and the market. As a considerable proportion of the economy, approximately one-third, remains subject to non-market forces, the more market oriented segment of the economy's costs are not based on market prices and are further distorted by the transaction costs associated with corruption (Kerr and MacKay, 1997).

China and the World Trade Organisation

The Peoples Republic of China has been attempting to join the World Trade Organisation (WTO), and the General Agreement on Tariffs and Trade (GATT) that preceded it, for fourteen years. This long quest for membership has made the Chinese leadership cynical about the process and has tended to confirm their suspicion of the organisation as a club for rich countries - the same rich countries which imposed the *Unequal Treaties* on China. The negotiations have been fraught with political difficulties. The Republic of China was an original signatory to the GATT in 1947 but voluntarily suspended its membership when it found it could no longer meet its obligations in the wake of the Chinese civil war and its retreat to Taiwan. The Peoples Republic of China has argued that it did not agree to the withdrawal of membership and contends that it does not have to go through the formal accession process as it is still formally a member. This Chinese view has not prevailed and the Peoples Republic of China has been forced into applying for formal accession. The vexing political problem of Taiwan remains. Taiwan is also seeking membership and, given its importance in global trade, has a number of allies in its quest for membership. The Peoples Republic of China has insisted that Taiwan should not be allowed to accede until after China has formally joined. Taiwan and its allies worry that once in the WTO, the Peoples Republic of China will be able to block Taiwan's membership. A likely compromise will see Taiwan enter at the same time as China as a separate customs territory in an arrangement similar to that extended to Hong Kong when it reverted to Chinese sovereignty. The political issue of Taiwan's accession tends to blow *hot and cold* depending upon the general state of relations between China and Taiwan.

Another political problem with Chinese accession has been the insistence of some countries, particularly the US, that China should join the WTO as a developed rather than a developing nation. It is hard to imagine any other forum where China would be considered a developed country. By joining as a developed nation, China would be forced into meeting much stricter trade commitments and be denied the flexibility of longer periods for

compliance than developing countries which are members of the WTO (Yang, 1996). The US and some other member countries argue that China's vast size and population justifies it being treated as a non-traditional developing economy. Based on this *special case* argument, they state that China should accept the responsibilities of a developed nation in its WTO affiliation. It is just this type of behaviour which heightens Chinese distrust of foreign intentions and conjures up all of the images of the era of western imperialism. If there is any hope that China is to respect WTO disciplines, the organisation must not simply be written off as a modern version of the *Unequal Treaties* of the past (Ceko and Kerr, 2000).

Despite all of the political difficulties surrounding China's accession, the major problems have been economic rather than political. The WTO's set of trade conventions is based on the underlying premise that firms engaging in international trade are governed by market forces. Commercial criteria are expected to be the basis for the decisions of private firms engaging in international commerce. One can interpret the constraints on the ability of governments to extend protection or trade distorting support to domestic firms - tariffs, quantitative border measures, non-tariff barriers, export subsidies, domestic production subsidies - as attempts to ensure that trade is undertaken on the basis of commercial criteria. As suggested above, China's economy has not been and is not likely to be based on market forces in the near future. While command economies have been accommodated in the WTO in the past, these have been small economies which did not have the potential to significantly distort international trade. The sheer size of the Chinese market has the potential to considerably alter trading patterns and to change the nature of the WTO. As a result, member countries of the WTO have been working hard to ensure that when China accedes it will be able to substantially comply with WTO disciplines.

While there has been considerable emphasis on the reduction of tariffs by both WTO members and China, this aspect of WTO accession is much less important than other aspects of the administration of the Chinese trade regime. China has had a complex system of import licensing which has been used to restrict trade beyond the limits imposed by tariffs. Negotiations with China have emphasised the removal of the licensing system. It is not clear, however, whether the central government in Beijing still has the ability to ensure that local officials do not continue with *de facto* licensing when they have been officially removed. Much of China's trade has been conducted by state trading enterprise which do not follow commercial criteria (Rude, 2000). The WTO disciplines on state trading enterprises are weak (Annand, 2000). Thus, WTO members have been trying to ensure that state trading monopolies are eliminated prior to China's accession. A number of non-tariff barriers have figured prominently in Chinese trade policy, among them:

... perplexing technical standards including sanitary and phytosanitary ones applied to imports of farm products; ... testing, labelling, and certification requirements that are stricter for imports than for comparable domestically produced goods and often lack scientific validation ...(Prybyla, 1999, p. 21).

These regulations do not conform to WTO conventions and the WTO members want their discriminatory aspects eliminated prior to accession.

If China accedes to the WTO, it must take on the obligations of the TRIPS agreement to protect the intellectual property of individuals and firms of other member states. China and the US already have negotiated a bilateral agreement regarding the protection of intellectual property. In the agreement, China and the US promise to enforce penalties on any person or firm caught pirating, stealing or copying patented materials or copyrights. The US charges that China is not implementing the bilateral agreement. It states that the degree of infringement of materials remains high and no enforcement has taken place.

China asserts that it has complied with the bilateral agreement and is achieving progress with its enforcement. China also contends that the US has not complied with the agreement. Both countries have avoided sanctions against one another for breach of contract, but it is evident that the US has no confidence that the agreement will be honoured. According to Duesterberg (1999):

The much-heralded, bilateral intellectual property rights agreement has had to be negotiated twice owing to massive violations of the first agreement. Even now China confiscates illicit CD and CD-ROM equipment only to sell it to suspicious buyers in crime-ridden Macau. More than 90 percent of the software used in China is pirated (pp 17-18).

Even in the face of its dismal record in the intellectual property agreement with the US, China promises the WTO that with admission it will *improve its law enforcement and apply the provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods (TRIPS) as a developed economy* (Yang, 1996, p 665). It suggests that it can comply with its TRIPS obligations after a transitional period of only one year rather than the five years most developing countries adhere to. In reality, it is probably beyond the capability of the Chinese government to protect foreign intellectual property given the ease with which violations can be perpetrated and the ability of regional officials to act independently of the central government. The protection of intellectual property in agriculture is becoming particularly important due to the high proportion of the value of biotechnological products which is accounted for by intellectual property.

While these aspects of accession have been under negotiation, less attention has been given to two further substantive issues. The first is the ability of domestic state enterprises to distort input prices for firms directly engaged in international trade. If input prices can be set arbitrarily, then firms engaging in production for export, or which are producing import competing goods, can be arbitrarily given a strategic advantage over foreign competitors and may not compete on the basis of commercial criteria. Electric power, steel, fertiliser, vehicles and a host of other significant inputs are effected. Limited attempts have been made to negotiate the removal of state monopolies in input industries but this is not likely to have a significant effect on concessionary pricing of inputs to Chinese industry.

The second issue is the lack of transparency in decision making which is pervasive in the Chinese economy. Without transparency, it is not possible to ensure that decisions affecting foreign firms are made on a non-discriminatory basis. These two problems are likely to lead to a large number of disputes at the WTO once China accedes.

Given all of the changes which China will be required to make - many of which are anathemas to the philosophy of the Party - why has China sought WTO membership with such tenacity? The Chinese government sees WTO membership as a way to escape the capricious use of trade policy by foreign governments. As a non-WTO member, China currently conducts trade through a series of bi-lateral agreements with foreign countries. These agreements can lapse or can be withdrawn much more easily than WTO obligations. Other countries have used the threat of withdrawal of bi-lateral trade concessions for a range of non-trade reasons - e.g. human rights. Accession to the WTO would protect China from threats of trade actions for non-trade reasons. Given the Chinese leadership's poor regard for trade treaties with foreigners and its neo-mercantilist approach to trade in general, one might expect China's WTO activities to concentrate on acquiring as much protection from the capricious use of trade policy by foreign governments as it can while choosing to circumvent its WTO commitments when it is convenient. If this is the case, it does not bode well for those firms that wish to engage in international commerce with China and the future reputation of the WTO.

Current Negotiations

There was considerable optimism that a new broad-based round of WTO negotiations would be approved at the organisation's Ministerial Meeting in Seattle in November 1999. Having China be a member of the WTO and engage in the new round of negotiations seemed logical and politically desirable by a number of WTO members. As a result, there was a flurry of diplomatic activity in the weeks leading up to the Seattle meeting. To gain accession, China must negotiate bilaterally with WTO members. In November 1999 the US and China reached an accession agreement. Without an agreement with the US no deal could go forward because the US has political clout to deny China the votes of two-thirds of WTO member countries required for membership (Ceko and Kerr, 2000). On November 26th, Canada and China reached an accession agreement. The last major hurdle was an accession agreement with the EU and Chinese diplomatic efforts shifted to Brussels in the last few days prior to the Seattle Ministerial. No agreement was reached.

The Seattle WTO Ministerial Meeting's failure to produce an agreement to launch a new Round of broad-based trade talks means that any new Round will have to be delayed until sometime after the US election in the fall of 2000. This removed the urgency of China's accession and talks with the EU remain ongoing.

Agriculture Arrangements

The exact details of China's accession cannot yet be known for three reasons. First, negotiation of bilateral accession agreements with all WTO members, and in particular the EU, have not yet been concluded. Second, as negotiations are ongoing, countries do not wish to give other WTO members which are still negotiating with China a strategic advantage by releasing details of their agreements. Finally, once the individual bi-lateral arrangements are negotiated, then a meeting is held in Geneva to reconcile the bi-lateral agreements into a common accession document on a Most Favoured Nation basis. This means that the most favourable terms negotiated must be extended to all trading partners in a non-discriminatory fashion. Given these limitations, it is possible to get a general outline of the agricultural

provisions of Chinese accession from the summary information released by the Canada (DFAIT, 1999) and the United States (USDA, 2000).

The Canadian release provides much less detail than that of the US. If China's accession goes ahead, the release suggests Canada can expect improved market access for at least canola, canola oil, wheat, barley, malt, field peas, alfalfa pellets, ginseng and whiskey. China has agreed to implement tariff rate quotas (TRQs) which will allow low tariff access to the quota amount with higher tariffs on additional (out of quota) quantities. Two major Canadian products will be affected by TRQs, canola oil and wheat. The quantity portion of the canola oil TRQ will be set initially at 600,000 tons rising to 1.13 million tons in five years. After that no further quantitative restrictions will remain. Canola oil will face the same tariff as soybean oil, its major competitor. Wheat will also be subject to a TRQ. Initial levels will be 7.3 million tonnes rising to 9.3 million tonnes in four years.

A separate but parallel agreement between the Canadian Food Inspection Agency and China's State Administration on Entry-Exit Inspection and Quarantine was negotiated relating to sanitary and phytosanitary regulations. Chinese import regulations for Canadian seed potatoes, poultry, pork and beef are to be put on a *sound science* basis. A timetable to accomplish this transformation has been agreed.

The US information is more complete. It should be remembered that the US deal may be important for Canada because if it goes into effect the deal can be no worse for Canada under the Most Favoured Nation principle. Lower Chinese tariffs have been negotiated for a number of products - wine from 65 to 20 percent, cheese 50-12, beef 45-12, grapes 40-13, apples and cherries 30-10, poultry 20-10 and pork 20-12. Some of these reductions appear significant but may not actually turn into large increases in exports. Cheese plays only a limited part in traditional Chinese diets. Beef is less preferred than pork or poultry. Rising incomes, westernising taste and further expansions in the tourist industry will, however, lead to some increase in the market for beef.

As suggested above, however, tariffs are less important than other aspects of the Chinese import regime. China has agreed to eliminate its system of import licensing. However, this may be difficult to accomplish. The issuing of import licences is one of the most lucrative areas for bureaucratic corruption. According to Rodinelli (1993): *Applications for import licensing have had to be approved in many cases by a ministry controlling state enterprises that produce the same product domestically* (p 72). An official can slow the application process down or prevent competition by denying the application. Secret negotiations are common which facilitates bribery.

China agreed to remove 75 percent of its licensing requirements by 1995, but the practice has proved difficult to remove given the vested interests of the bureaucracy. There is much political opposition in the Party regarding import license removal. Since 1995, import licensing has decreased but still has not reached the 75 percent reduction that had been promised. Today, there is still confusion amongst importers about licensing, and many importers are refraining from applying for licences or have simply abandoned interest in importing into China altogether (Ceko and Kerr, 2000).

Where licensing is removed, TRQs will be put in place. China has committed to within quota tariffs of one to three percent on wheat and soybean oil. In an attempt to reduce the influence of China's state trading enterprises that can and do make importing decisions on a non-market basis, the US has insisted that a portion of the quota segment of TRQs be imported by entities other than state trading enterprises. Further, a set of rules has been agreed for the administration of TRQs. The degree to which Chinese state trading enterprises will still be entitled to dominate trade has not been made clear. The US is certainly attempting to deal with the state trading enterprise problem. In addition to the removal of the state trading enterprise monopoly on importing, except for a wheat and a few other commodities where some trade will continue to be channelled through state trading enterprises, any entity will be allowed to engage in importing, not simply those who receive authorisation from the Chinese government. Further, China has agreed to liberalise its agricultural distribution system so that US (and Canadian) firms can import, distribute and market their own products. This provision does not apply tobacco.

China has also agreed to eliminate its use of export subsidies in agriculture. It should be noted that this is a stronger commitment that is required for WTO members, including the US and the EU, under the existing Uruguay Round Agreement on Agriculture. How important this is when major inputs such as fertiliser can be priced by state firms on a non-commercial basis remains to be seen. China has also agreed to cap, and then reduce, domestic trade distorting subsidies at WTO negotiations. Again, how non-market pricing is treated will be crucial.

China has made the commitment that state owned enterprises will buy and sell on commercial considerations. US firms are to be allowed to sell and buy from state-owned enterprises. Sales to state-owned enterprises will not be considered government procurement where the WTO allows transactions on a non-commercial basis. While the commitment has been made, one wonders about the plausibility of enforcing these provisions in an economy as vast and diverse as China's. One wonders about both international enforcement and the ability of the government in Beijing to impose its will on the provinces.

Conclusion

If China does accede to the WTO in the near future, the integration of China into the international trading system and the WTO disciplines is likely to be difficult. China has always chafed under obligations imposed from outside. Until the benefits of trade are accepted by China on their own merit rather than as an adjunct to government development policy, disputes are likely to be common and market access less than expected for a range of goods not considered a priority by China's government, including agricultural products. It is probably prudent that agri-business firms take a cautious approach to investments premised on improved access to Chinese markets if China accedes to the WTO

ENDNOTES:

1. Agreement Containing Rules of Trade, Made in Pursuance of Article XXVI of the Treaty of 26th June 1858 signed at Shanghai, 8th November 1858 as reprinted in Inspector General of Customs (1917), p 424.
2. Commercial Treaty (1903) as reprinted in Inspector General of Customs (1917), pp 753.

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