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China's WTO accession: why has it taken so long?

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Abbreviations

APEC	Asia Pacific Economic Cooperation
ATC	Agreement on Textiles and Clothing
BTA	Basic Telecommunications Agreement
CASS	Chinese Academy of Social Sciences
CIA	Central Intelligence Agency
EAAU	East Asia Analytical Unit
EVSL	Early Voluntary Sectoral Liberalisation
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GITIC	Guangdong International Trust and Investment Corporation

ITA	Information Technology Agreement
MFA	Multifibre Arrangement
MFN	most favoured nation
MOA	Ministry of Agriculture (People's Republic of China)
MOFTEC	Ministry of Trade and Economic Cooperation (People's Republic of China)
NGO	non government organisation
NPC	National People's Congress (People's Republic of China)
PLA	People's Liberation Army
PPP	Purchasing Power Parity
SOE	state-owned enterprise
SPS	sanitary and phytosanitary
TCK	Tilletia contraversa kuhn
TRIMs	Trade-related investment measures
TRQ	Tariff rate quota
TVE	township and village enterprises
USITC	US International Trade Commission
USTR	United States Trade Representative
WTO	World Trade Organisation

China launched its campaign for accession to the World Trade Organisation (WTO) in 1986. After nearly 14 years of effort, the light at the end of the tunnel now seems to be in sight after the conclusion of the Sino-US negotiations on 15 November 1999. The question is why accession has taken so long and what lessons can we learn from the process. Answers to this question will help shed some light on the prospects for conclusion of China's WTO accession and the implications of this for other transition economies which are also seeking WTO accession.

There is little doubt that both China and its trading partners would benefit from an early resolution of China's WTO accession—it will not only enhance market access for both sides, but also reduce uncertainty over trade relationships. For China, WTO accession will help it move towards a rules-based economy. There will be also political spin-off from improved bilateral relationships between China and its major trading partners, especially the United States.

The core of the problem is that China's WTO accession has been so politicised that it has gained its own political life. Vested interests are so entrenched (both in China and its trading partners) that it has been difficult to break the political log-jam. A break-through such as the one which occurred in November 1999 requires either extraordinary political will or unanticipated events that change the political equilibrium so that there is greater incentive to reach agreement.

This paper examines the accession process from several angles. It first offers a review of the current state of the accession negotiations, with particular focus on the outcome of negotiations between China and the United States achieved in November 1999. This is followed by a brief assessment of the Sino-US Agreement. The economic foundations of China's WTO accession will then be discussed. As suggested earlier, the economic approach based on national welfare considerations is inadequate for explaining why agreement was not reached earlier. We must therefore resort to a political economy approach to see how interest groups have driven the accession process. This approach is then further broadened to examine the politics of China's WTO accession. The prospect for a final conclusion of the negotiations is examined in the last section.

The current state of negotiations

Despite the frustration expressed by many observers prior to the Sino-US agreement in November 1999, China's WTO accession negotiations had achieved a great deal. China had reached agreements with most WTO members. After the Sino-US agreement and subsequent agreements with Canada, Brazil, Sri Lanka, and Cuba, 23 countries remain that are yet to conclude negotiations with China. Among these, the most important are the European Union, India, Thailand and Switzerland. The Sino-US agreement has removed the greatest hurdle in the accession process, and it best represents the current state of the accession negotiations.¹ According to a White House Summary of the US-China Bilateral WTO Agreement (White House 1999), China agreed to reduce its tariffs on agricultural commodities from the present 31.5 per cent to 17 per cent and to 14.5 per cent for US exports by January 2004.² All tariffs are to be bound. In the most sensitive sectors, particularly grain, China will adopt tariff-rate quotas (TRQs). In-quota tariff rates will be minimal—ranging between 1 and 3 per cent. Above-quota tariff rates were not announced, but initial quotas are generally well above the present

import levels and the growth rates of the quotas are generous. The United States Trade Representative (USTR) claims that China's agricultural tariffs will be comparable to or better than those of many major US trading partners (including developed countries) after the reductions. US companies will be able to import and distribute products in China independently. China will also eliminate sanitary and phytosanitary (SPS) barriers that are not based on scientific evidence. In addition, China made a commitment not to subsidise agricultural exports.

In terms of industrial products, the United States claims that China has agreed to allow freedom for US firms to import, export and distribute their goods within China; significant reductions to bring tariff levels to levels comparable with major US trading partners and below those of most developing countries; binding of all tariff concessions; and phasing out of all quantitative restrictions on imports. Table 2 shows the agreed tariff reductions. It has been estimated that China's average tariff on industrial goods will decline from present 24.6 per cent to 9.4 per cent (7.1 per cent for US priority goods). In addition, China will sign up the Information Technology Agreement (ITA), eliminating all tariffs on products such as computers, telecommunications equipment, semiconductors, computer equipment and other high technology products.³

Similar to its commitments in agriculture, China will allow US companies to trade and distribute manufactured goods.⁴ This covers sectors which have been subject to strict restrictions in the past, including wholesale, transportation, maintenance and repair. Trading rights will be phased in over three years.

Non-tariff barriers will be eliminated, with maximum phase-in periods of five years, but most will be eliminated by 2002. Quotas on the so-called US priority products, namely, optic fibres, will be eliminated upon accession. Automobile quotas have the longest phase-in period and will stay in place until 2005. In the interim, the base level quota will be US\$6 billion. Like all other quotas, they will grow at 15 per cent annually until elimination.

Table 1 China's present and agreed tariff levels for agricultural commodities (per cent)

Commodity	Present	2004
Beef	45	12
Pork	20	12
Poultry	20	10
Citrus ^a	40	12
Grapes	40	13
Apples ^a	30	10
Almonds ^a	30	10
Cheese	50	12
Ice cream ^a	45	19
Fish ^a	Above 20	10
Wine	65	20

Note: ^a These are rates released by the USTR in its April 1999 Press Release, but not confirmed in the White House Summary. Since the rates that are confirmed are the same as those in the USTR Press Release, one can assume with reasonable certainty that the unconfirmed rates remain the same in the agreement.

Source: White House Office of Public Liaison (1999); United States Trade Representative (1999).

Table 2 China: agreed tariff reductions for industrial products (per cent)

	Present	Agreed
Information technology	13.3	0.0
Automobiles	80–100	25
Wood	12–18	5.0
Paper	15–25	7.5
Chemicals	Up to 35	0.0–6.5
Distilled spirits	61	10

Source: United States Trade Representative (1999).

On service industries, the United States claims that China has made comprehensive commitments to eliminate most foreign equity restrictions with reasonable transition periods—mostly within five years. The commitments cover banking, insurance, distribution, telecommunications, securities, professional services, audiovisual, travel and tourism. These were the areas where the United States and China encountered the greatest differences during the negotiations in April 1999 when Zhu Rongji was visiting the United States.

The agreed commitments mostly seek to reduce restrictions on the scope, location, and equity investment in service industries. Under the agreement, foreign interests will be allowed in virtually all service industries without the geographic restrictions which are prevalent at present. Specifically, China undertakes to phase out restrictions on distribution and its auxiliary activities (such as rental, leasing, air courier, freight forwarding, storage and warehousing, advertising, technical testing and analysis, and packaging services), mostly within three years. Wholly foreign owned subsidiaries will be allowed in these auxiliary services.⁵ On telecommunications, China will become a member of the Basic Telecommunications Agreement (BTA). This means that China will implement the so-called pro-competitive regulatory principles and technology-neutral scheduling embodied in the BTA. Upon accession, markets will open in the Beijing–Shanghai–Guangzhou telecommunications corridor, which represents three-quarters of all domestic traffic, while restrictions in other geographical areas will be phased out over two years. Foreign ownership of up to 49 per cent (50 per cent for value-added paging services), will be allowed in five to six years.

On insurance, China will permit foreign firms to insure large scale risks nationwide upon accession, and will eliminate all geographic restrictions within 3 years. Group, health, and pension lines of insurance will be phased in over 5 years. 50 per cent foreign ownership is allowed for life insurance, while, for non-life insurance, 51 per cent foreign ownership is permitted and wholly foreign-owned subsidiaries can be established. Reinsurance will not be subject to any restrictions after accession.

China has committed to full market access to its banking sector within five years. This means that foreign banks will be allowed to conduct local currency business with Chinese enterprises starting 2 years after accession, and with Chinese individuals from 5 years after accession. Both geographic and customer restrictions will be removed in five years. In addition, nonbank financial companies will be allowed to provide automobile financing.

Under the November agreement, China will permit minority foreign owned joint ventures to engage in fund management on the same terms as Chinese firms, to underwrite domestic securities issues and to underwrite and trade in securities denominated in foreign currencies. As regards professional services, China has committed to opening markets in legal, accountancy, taxation, management consultancy, architecture, engineering, urban planning, medical and dental, and computer and related services. Majority foreign ownership is allowed for all professional services except for practicing Chinese law.

On audiovisual products, China has undertaken to import 40 films after accession and the number of imported films will grow to 50 in three years, of which 20 films will be revenue sharing in each of the three years. On travel and tourism, majority foreign ownership of hotels will be granted upon accession and full foreign ownership will be allowed in three years. Foreign travel operators will be able to provide the full range of travel agency services, and access will be given to government resorts as well as Beijing, Shanghai, Guangzhou and Xian.

It is claimed that China will comply with the Trade-Related Investment Measures (TRIMs) Agreement and the WTO Agreement on State Trading. There are, however, three particularly noteworthy aspects of the Protocol. First, the United States will be able to treat China as a non-market economy for the purpose of antidumping and countervailing purposes. This means that the United States will be able to use third country reference prices to determine if Chinese export firms are dumping or if Chinese exports have been subsidised. This practice will remain effective for 15 years after China's accession to the WTO. Second, the United States can unilaterally apply restraints on Chinese exports based on standards that are lower than those in the WTO Safeguard Agreement. This provision will last for 12 years following China's WTO accession. Finally, the agreement stipulates that Multifibre Arrangement (MFA) quotas on Chinese goods will be phased out by 2005, but the United States will be able to use a safeguard provision drawn from the 1997 Sino-US Textile Agreement to restrict Chinese textile and clothing exports until 2008—four years after MFA quotas will have been phased out for all other WTO members.

Assessment of the Sino-US Agreement

The Sino-US Agreement is comprehensive. It covers agriculture, industry, services, as well as protocol issues. The most salient feature of the agreement, however, is the extensive use of the phase-in approach to accommodating China's demand for adjustment. This seems to be a sensible approach given the transitional nature of the Chinese economy. Without such phase-in periods, political resistance in China would have been much stronger and an agreement would have been more difficult. This is the compromise necessary for concluding the negotiations (Yang 1999). The danger of this approach is, of course, that implementation could be delayed if political resistance grows. Apart from this, any ambiguity over the process of implementation could lead to disputes. The technical capacity of various levels of governments in carrying out necessary reforms could also cause delays and deviations from what the agreement is intended to achieve. Most importantly, China's social institutions are still in the process of rapid transition, and it is perhaps unrealistic to expect that they will meet demand upon accession. Having said

that, the phase-in approach does not necessarily mean slower liberalisation. On the contrary, opening markets immediately without adequate planning and preparation could mean chaos and, hence, could cause even more delays in true market access.

This last point is especially pertinent to banking sector reform. It is widely acknowledged that, in its present form, China's banking sector is susceptible to external shocks. After the Asian Crisis, the weaknesses of the banking system have been exposed. The four pillar state banks have accumulated huge debts and are technically insolvent (Lardy 1998; Huang and Yang 1999). The banks were all recapitalised by the government in 1998–99, and have been kept afloat only by continuous increases in private savings. Underdevelopment of the capital market has forced Chinese investors to invest most of their savings in the banks. In addition, many non-bank financial institutions have also developed financial difficulties, and their problems do not seem to have been fully exposed by the collapse of GITIC (Chinese Academy of Social Sciences 1999). The government has tightened its regulation of the non-bank financial institutions.

Recapitalisation of the state banks and other financial institutions has not resolved the fundamental problems in the Chinese financial system. Apart from the poor management of these financial institutions, the poor financial performance of the state-owned enterprises (SOEs) has been at the root of the problems in the financial sector. Banks are forced by the government to finance losses suffered by the SOEs. This has created a great moral hazard problem. Expecting that the government will bail them out if in trouble, SOEs do not have adequate incentives to improve their performance. Having to finance SOEs regardless of their financial soundness makes the banks less accountable.

The opening of China's financial sector without fundamental reform in the state sector certainly carries a substantial risk. It should not be surprising that domestic banks will be deprived of private deposits when foreign banks are allowed to attract them. Better risk and financial assessment of borrowers by foreign banks can also deprive domestic banks of good investment opportunities. With reforms severing the budgetary links between state banks and enterprises, one would expect the performance of the banks to improve. The questions are: can SOE reform be carried out rapidly enough to eliminate the burden of the banks? Given the time they are allowed, can the banks improve their management sufficiently to compete with the foreign banks? In the longer run, the participation of foreign banks in the Chinese market will improve the efficiency of the domestic banking system, but problems may well arise in transition when domestic banks contract rapidly in the face of foreign competition. Joint ventures between domestic and foreign banks will presumably help the domestic industry, but how this will be worked out is not clear.

This warning is not meant to suggest that China should have bargained for a longer transition period—doing so may well have delayed domestic reform. Nevertheless, the five year transition period has certainly set a tight time frame for reform in the banking and SOE sectors. Past experience suggests that extraordinary political will and management skills will be needed to accomplish such a task in such a short period of time. It is possible that the deadline will induce more forcible reform; it could also mean that China will be unable to honour its commitments in time, or could lead to financial turmoil if poorly managed.⁶

Market access to China's service industries has been a stumbling block in the past. Although agreements have been reached, this will continue to be a difficult area for implementation. Apart from the problems mentioned earlier in relation to the banking sector, implementation in other areas may also prove to be difficult. For example, audiovisual services have been a very sensitive area. Over the past twenty years of reform, China has been consciously trying to avoid Western cultural influence while gradually integrating the country into the world economy. The industry will no doubt take advantage of this concern and rally support from conservative forces to maintain the *status quo*. Any change in the domestic political environment could provide an opportunity to compromise the commitment to market opening.

Market access is very uneven across industries. It is worth noting that the automobile industry will enjoy much higher tariffs than other industries. Similarly, some service industries, such as telecommunications, have been subject to less rigorous market opening. International and domestic services, for example, will be allowed 49 percent foreign investment within six years. Domestic industries enjoy enormous market power in these markets. In terms of efficiency, however, these industries should be subjected to greater market access in order to bring their protection to a level comparable to those prevailing in other industries.

Some of the protocol provisions in the Sino-US agreement will greatly facilitate domestic reforms in China, benefiting both China and its trading partners. In particular, the abolishment of foreign exchange and local content requirements will reduce the associated distortions and increase economic efficiency. The elimination of the technology transfer requirement may appear to disadvantage China, but it is doubtful that such a requirement has facilitated technology transfer in past, because it is difficult to enforce and verify any technology transfer detailed in foreign investment agreements. The required transfer is often associated with concessions by the Chinese government in other areas, such as tariff exemptions on imports of so-called hi-tech products. It has fostered domestic interest groups who want to maintain preferential policies for particular imports and special economic zones.

The Sino-US agreement also requires SOEs and state-invested enterprises to undertake their business activities on a commercial basis, providing foreign enterprises with the opportunity to compete with domestic enterprises. The Chinese government has also committed not to interfere with the commercial decisions of SOEs and state-invested enterprises except in a manner consistent with WTO rules and principles. In addition, purchases of goods and services by these enterprises will not constitute government procurement. All these are consistent with the domestic reform agenda and should help China establish a competitive state sector as part of the on-going SOE reform program. Enforcement of these rules will be difficult, however, given the close relationships between state enterprises and the government and the inertia of government officials for market intervention.

The Sino-US agreement on US anti-dumping and countervailing practice against Chinese imports will subject Chinese exporters to continued discrimination. This is consistent neither with the transition periods allowed for market opening nor the current status of marketisation of the Chinese economy. If China were to commit to accomplish market-access reform in most

industries within five years, the current US anti-dumping and countervailing practice and discriminatory unilateral import restrictions should cease to be applicable at the end of the transition, when the Chinese trade regime is deemed to have become consistent with WTO rules. In fact, to stipulate a cross-the-board provision discriminating against all Chinese enterprises does not accord with reality. China's most competitive exports are produced by the non-state sector, which is subject to limited government interference in terms of pricing and subsidies (East Asia Analytical Unit 1997; Yang 1995). Even though it would be difficult to distinguish between state and non-state enterprises, it would have been logical to treat the Chinese economy as market-based in five years on the condition that the market opening agreement be fully implemented.

Since the continuation of the current US antidumping and countervailing law is supposed to address any unfair competition by individual Chinese firms practicing predatory pricing and receiving government subsidies, then it is natural that any other contingency protection should be invoked under the normal WTO safeguard provisions. Once the special anti-dumping and countervailing measures are allowed, permitting the United States to target Chinese exports unilaterally at standards lower than the WTO safeguard provision is a blatant violation of the non-discrimination principle. Apart from the economic consequences, this is likely to generate more trade disputes between China and the United States.

The agreement on textiles and clothing is a further violation of the non-discrimination principle. It is widely acknowledged that most of China's textile and clothing exports are produced by the non-state sector, especially the so-called township and village enterprises (TVEs) and foreign invested firms from newly industrialising Asian economies. To subject China's textile and clothing exports to a special safeguard provision beyond the ATC allows the United States to discriminate against Chinese exports. It is not clear whether textiles and clothing will be subject to the special safeguard provision governing all other imports from China for 15 years following China's accession to the WTO.

These conditions set a precedent for discrimination against transition economies under the auspices of the WTO. Though some form of discrimination may be justified while these economies are not sufficiently market-oriented, continued discrimination should be guided by the process of transition in these countries not by rigid time frames. The notion that these economies are transitional does not necessarily mean that their exports are distorted by firm pricing behaviour or government subsidies.

The economics

The economics of China's WTO accession seem to be unambiguous—entry to the WTO will benefit China in several ways. It will benefit Chinese consumers as a result of reductions in trade barriers. One does not have to look hard to find a commodity for which Chinese consumers pay twice as much as consumers in most other countries. Cars are one such commodity. Certainly, some industries—especially some heavy industries—will be hurt by tariff reductions, but other industries will expand because of improved access to overseas markets and reduced costs of imports. In the end, overall economic activity will expand, because resources will be used more efficiently.

That is, China will be able to produce more given its available resources as inefficient resource uses are abandoned for more efficient.⁷ Inevitably, these economic benefits are reduced by the fact that tariffs on several industrial commodities will remain high even after the WTO accession.

Increased openness in service industries is particularly beneficial even though it may cause difficulties in the short run. China's service sector is the least open across all sectors of the economy. Greater market access by foreign firms will not only increase domestic competition, but also bring in scarce skills in the service industries. Such skills are especially critical in industries such as banking, insurance and professional services.

Perhaps the largest benefit of WTO accession to China is the impact on its trade regime. China's current trade system has evolved from one of central planning. The system is full of inconsistencies but short of transparency and rationality. When China replaced trade planning with border measures, the broad pattern of trade restrictions was retained. This pattern is clearly biased towards import substitution (He and Yang 1999). Trade measures are hardly exposed to public debate so most people would not have a clue about the trade restrictions on various commodities. Tariffs and other barriers are often changed and their application depends on who the importer is. Information on trade regulations is often not available in the public domain. This is also at the centre of complaints by China's trading partners about the lack of transparency in the trade regime. Greater transparency in the trade regime will also have profound implications for the rest of the economy. In particular, it sets the course for reform of the SOE sector and helps establish rule-based domestic institutions. These trickle-down effects are likely to be substantial.

Other benefits are also likely to be significant. First, lower protection and greater transparency would reduce the rampant corruption that has caused great concern amongst the authorities and ordinary citizens. Smuggling would fall and, ironically, tax revenues from import duties could rise, because lower tariffs and greater transparency would reduce the incentive for, and hence incidence of, smuggling.⁸ After all, all these are consistent with China's objective of building a modern, market economy and 'socialist spiritual civilization'.

To many Chinese policy makers, the largest gain from WTO accession is increased access to overseas markets. Although China has most favoured nation (MFN) access to almost all overseas markets, there are nevertheless tangible benefits from WTO accession. First, many of China's trading partners may have to reduce their non-tariff barriers against China. Antidumping duties and countervailing duties are often levied on Chinese exports on the grounds that China is a non-market economy and its export prices do not reflect the true cost of production. Often third country reference prices are used to benchmark the Chinese prices. At the moment, China deals with these often discriminatory restrictions through bilateral negotiations. This can be costly. While other WTO members will continue to treat China as a non-market economy after its accession to the WTO, China will be able to use the WTO dispute settlement mechanism to defend its interests. Of course, the special safeguard, antidumping, and countervailing provisions in China's Accession Protocol will diminish the benefits of the dispute settlement mechanism to China. Once in the WTO, China will have more influence over the path of future rounds of WTO negotiations, especially with regard to rules on antidumping and countervailing. This will benefit

China as well as other developing countries. This is particularly important in areas such as textiles and clothing.⁹ Potential longer-term benefits include more balanced treatment of environmental and social issues (such as labour standards) in future WTO rounds.¹⁰

China's WTO accession will undoubtedly benefit most of its trading partners.¹¹ China's wider market opening and greater transparency will enhance global trade. Equally, reductions in restrictions against China, such as anti-dumping duties and the removal of MFA quotas will benefit consumers in industrial countries. One thing that must be noted is that China's WTO accession will benefit China more than any other country. This is because, as indicated by standard economic theory and empirical research, most of the gains from liberalisation are reaped by the liberalising countries, even though trading partners gain from increased market access (Anderson 1997; Yang 1996; Bach et al. 1996). In the debate on China's WTO accession, the benefits to China's trading partners are often perceived to be the most important (especially by politicians when they talk about how many jobs will be created and how exports will be increased). This may seem to have given greater importance to China's WTO accession, which may help the accession process, but at the same time, it creates false expectations and hence place greater demands on China. Negotiations become difficult to conclude if the goalposts keep moving.

The political economy

False expectations arise partly from the lack of understanding of the economics of trade liberalisation, but perhaps more importantly because of the lack of appreciation of China's economic significance in the world market. China has the world's largest population and hence potentially the largest market. China, however, is still a poor country, and its aggregate GDP is not much larger than that of Canada if measured at the market exchange rate. GDP comparisons based on purchasing power parity (PPP) would lift China's ranking significantly, perhaps to the third largest economy after the United States and Japan according to some estimates (Garnaut and Ma 1992; IMF 1993; Ren and Chen 1995), but China's global market significance is far less than its PPP-based GDP would suggest.¹² The underestimation of China's real GDP based on market exchange rates primarily results from the comparatively low prices of non-tradable goods and services owing to low labour costs (Ren and Chen 1995). Although this indicates that there may be greater potential for investment in China, its potential for trade is related more to its

Table 3 Macroeconomic effects of trade liberalisation on China, 2005 (per cent)

	As a developing economy	As a developed economy
Real GDP	4.0	4.4
Real wage	2.2	2.8
Exports	29.8	35.4
Imports	35.9	45.5

Source: Yang (1996)

income measured at the market exchange rate. In other words, China's significance in the world market is more likely to be determined by its tradable sector. Market penetration of the tradable sector in China is already quite high by the standards of large countries.

While the false hope that every Chinese citizen may be able to buy a pair of woolen socks has raised the stakes of market access, the perception that China will flood the world market with cheap goods has helped to strengthen protectionist pressures in industrial countries. Chinese-made garments, travel bags, footwear and golf balls are everywhere.¹³ To many, the logical extension of this market penetration is that China will soon be able to compete in many other industries. The likely truth is that it will take China many years before it starts to export capital and skill intensive goods at a scale that will threaten the dominance of industrial countries in these industries.¹⁴ China's total exports are not that much larger than those of the Republic of Korea.

It is not surprising, therefore, that in the negotiations over China's WTO accession, industrial countries have been trying to include special safeguard provisions to curb China's most dynamic exports. If the Sino-US Agreement of November 1999 is any indication, such provisions will be part of the accession protocol. These provisions are often based on an out-of-date assessment of the Chinese economy, or simply a reflection of protectionism. It is true that the Chinese economy today has inherited many remnants of central planning, but prices of tradable commodities are now largely determined by the market (East Asia Analytical Unit 1997). This is especially true for export commodities, most of which are produced by the non-state sector. Even for commodities that are produced by the state sector, prices are mostly determined by the market because of competition. To assess China's export costs on the basis of a comparison countries which have much higher labour costs than China can only be interpreted as protectionism.¹⁵

As expected, labour-intensive industries are most opposed to China's WTO accession. This is most evident in the textile sector.¹⁶ Under the Uruguay Round Agreement, the United States and other industrial countries will phase out all MFA quotas by 2005. The United States had been insisting on maintaining its MFA quotas beyond this deadline, but only the special safeguard provision was ultimately included in the Sino-US Agreement. The tactics employed by the United States against imports from China include allegations of illegal transshipment and customs fraud by Chinese exporters and exports of products made by prisoners and the People's Liberation Army (PLA).¹⁷ These products range from simple metal products to farm products. This campaign has won support from human rights groups and receives great publicity, climaxing each year when the US Congress votes on renewal of China's MFN status.

There are industries which see direct benefits from China's WTO accession. US hi-tech industries—for example, aircraft manufacturing—have been generally supportive of China's WTO entry. Lobbying by those industries for China's WTO accession intensified during Zhu Rongji's visit to the United States in April 1999. However, the influence of these industries was unable to match that of trade unions and other protectionist forces within both the Democrat and Republican Parties. The business effort seems to have been undermined by allegations that some US companies have illegally transferred technology to China. This has often put the industries in a

defensive position with respect to the forces against trade with China. In the end, China and the United States were not able to sign an agreement on China's WTO accession in April 1999. It was widely regarded by WTO observers that China's offer in April had far exceeded US expectations and was acceptable to US negotiators (Lardy 1999; Bottelier 1999), and that political considerations prevented the signing of a package on China's WTO accession.

The failure to reach agreement in April 1999 alarmed the US business lobby. Pro-accession companies have since put greater pressure on the Clinton Administration to reach an agreement with China. Paradoxically, the bombing of the Chinese Embassy in Belgrade in May 1999 by US military units seemed to have soured the Sino-US relationship to such an extent that it invoked more strategic considerations of the relationship in the United States, and also put the United States in a defensive position. The meeting between Presidents Clinton and Jiang during the Auckland APEC Summit provided a timely opportunity to reverse the deterioration of the relationship. China's accession to the WTO is an appropriate focus in repairing the damaged relationship. After all, Zhu Rongji's offer in April 1999 was rejected largely because of political considerations. China's commitment to fixed yuan-dollar parity since the Asian Crisis also seems to have helped in the process.

On the Chinese side, interest groups are equally forceful. Not surprisingly, opposition is strongest from sectors that have been most protected, namely, heavy industries (such as machinery, automobiles and chemicals industries) and service industries, including domestic distribution, banking, insurance and telecommunications. Lobbying for agricultural protection has also been strong, but has been driven mainly by agricultural bureaucrats and scientists. Heavy industries are still dominated by the SOEs despite 20 years of economic reform. SOEs have suffered from low efficiency and poor financial performance and many are suffering huge losses (see a brief survey by Huang et al. 1999). The widespread expectation is that, if these industries are liberalised, SOEs will contract as a result of competition from foreign imports. Potential unemployment in the SOE sector has been a central concern of the Chinese government (Fan et al 1998).¹⁸ Industrial interest groups have seized upon this, arguing that WTO accession will be detrimental to the national interest.

The offer made to the United States by Premier Zhu Rongji in April 1999 alarmed these industrial interests, causing their lobbying to intensify and become more overt. It was rumoured that upon learning that the telecommunications sector will be opened much wider to foreign competition and ownership, the head of the Telecommunications Department resigned in protest.¹⁹ It was also reported that officials from the Ministry of Agriculture (MOA) and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) had clashed over Premier Zhu Rongji's offer on agriculture during his April visit to the United States (Lam 1999). On learning that wheat from the US Northwest Pacific states would be allowed to enter the Chinese market, MOA officials asked the MOFTEC officials if they were willing to take responsibility in the 'calamitous event' that the TCK smut spread to wheat producing provinces in China. The MOFTEC officials reportedly bowed their head and could not say a word. According to the same source, MOFTEC officials were severely grilled when they tried to explain to ministries the planned concessions in areas ranging from banks and videos to cars and telecommunications.

In recent years, ministries representing industrial interests have become more forceful and overt in their opposition to trade liberalisation in their areas. According to these ministries, the substantially improved offer by Zhu Rongji has simply gone too far. Industrial groups have also rallied support from the conservative camp, which has even branded Zhu as a 'traitor'. It is rumoured that Zhu Rongji offered his resignation to President Jiang under intense pressure following his trip to the United States. This perhaps explains his muted role after April 1999, especially in the negotiations leading up to the agreement on 15 November 1999.

The politics

Since China launched its campaign to join the WTO 13 years ago, the politics surrounding the campaign have experienced dramatic change. The watershed events were the Beijing Massacre of 1989 and the subsequent collapse of the Soviet Union and the Communist Bloc. These two events changed the parameters of China's relationship with the West. Prior to the events in Tiananmen Square, China enjoyed a honeymoon in its relationship with the West, largely because China had embarked upon a course of economic reform while other socialist countries were still practising central planning. The Chinese government was widely regarded as a benign regime and one that, with time, could well proceed with both economic and political reform. The persistence of the Cold War meant that the West had a strong interest in maintaining a strategic relationship with China in order to counter the Soviet Union. Tiananmen shattered the image of the Chinese Government—China was no longer a progressive country, but one ruled by a repressive regime. The collapse of the Soviet Union and Eastern Bloc further undermined the basis for a strategic relationship between China and the West. Now China was not only ruled by a repressive regime, but was also a threat to world peace. China's assertiveness in its claims over the disputed waters and islands in the South China Sea was seen as a reflection of Chinese expansionism and its potential as a destabilising force in the world, particularly in the Western Pacific. Taiwan's democratisation added another dimension to the political relationship between China and the West, particularly the United States.²⁰ One could imagine that without Tiananmen and the collapse of the Soviet Union, the West would probably have let China accede to GATT out of political and strategic considerations. Lack of market mechanisms would probably not have been a major obstacle as China could have entered GATT under the Eastern European models. It is difficult to assess whether this would have been desirable. An earlier accession could have accelerated Chinese reform or it could equally have reduced the incentive for further reform. On balance, it would have been more likely to lock in a semi-reformed trade regime—a bad outcome for GATT/WTO.

China's perception of the West has also changed dramatically. After Tiananmen, the Communists further strengthened their belief that the West was only interested in democratisation of China and the Chinese market. Given such a belief and the fear of losing control over Chinese politics, the government has been emphasising patriotic education in addition to socialist doctrines. Its propaganda campaign has been greatly helped by a number of events in the 1990s. These events include the forceful inspection of a Chinese cargo ship suspected by the CIA of

carrying ingredients for chemical weapons heading to the Middle East, China's failed bid for the 2000 Olympics, the Taiwan Strait Crisis in 1996, and, of course, the bombing of the Chinese Embassy in Belgrade in May 1999. The involvement of the United States in these events has aroused much resentment in China, and perhaps increased suspicion of the West in general. The publicity these events received in the official media has made it easier to generate protectionist sentiment among domestic constituencies.

It is fair to say that, over the years, the Chinese political system has become more transparent. The conservative forces against reform have been substantially weakened, but the industrial lobby has become much stronger. This is because, under the current economic system, the financial performance of enterprises increasingly affects the welfare of managers and workers, unlike under central planning where remuneration bore no relation to enterprise profitability (He and Yang 1999). Lack of transparency in the economic system encouraged rent-seeking and behind-the-scenes lobbying. The threat of massive unemployment as a result of SOE restructuring makes Chinese politicians more sensitive to popular sentiment and the demands of industries and local governments. Senior Chinese leaders no longer have the luxury of overwhelming power in decision making. This is clearly demonstrated in the rebuff of Zhu Rongji's WTO offer by the ministries. From the Chinese government's point of view, the key issue is how to ally support for WTO accession and economic reform in this new political environment. Zhu Rongji has to learn how to consult with different interest groups and build consensus on the WTO issue.

Prospects

With the signing of Sino-US WTO agreement, China's accession to the WTO does not seem too far away. There are, however, several hurdles to overcome before China becomes a WTO member. Normal WTO accession procedures require that once bilateral negotiations have been successfully concluded, a WTO Working Party must report on China's WTO accession and the Protocol of Accession must be presented to members for comment. Subsequently, China has to sign on the Schedules of Goods and Services and the Protocol. All this will take time. There is another complication. Even though the US Congress does not have to vote on China's WTO accession, it must repeal the Jackson-Vanik Amendment so that permanent MFN status can be granted to China.²¹ Otherwise, the United States has to invoke the non-application clause in the WTO agreement.

This latter option would have grave consequences for Sino-US relations. Congress would be under great pressure to approve China's WTO entry. If nothing else, US-China businesses would certainly step up their lobbying, fearing the loss of business opportunities to competitors. If all other WTO members accepted China's accession, the United States would be seen as isolated and lose international support if it continued to deny China WTO membership. Should the United States invoke the non-application clause of the WTO agreement, it would plunge the Sino-US relationship into another crisis. How long it would take to rebuild the relationship from there is anyone's guess.

The congressional vote will not be an easy one. Interest groups have started to gear up their lobbying against the Sino-US Agreement. US labour groups and members of Congress have issued strong statements threatening to block the deal in Congress. The Congressional Progressive Caucus, a group of 53 congressmen—mostly Democrats allied with Labour unions—has recently declared its opposition to China's WTO entry (*China News Digest*, 7 February 2000). In a positive development, Trent Lott, the Republican majority leader in the US Senate, has switched sides recently, declaring his support for China's WTO entry, albeit demanding conditions on various issues, such as Taiwan, weapons technology transfer, human rights, and religious matters (*China News Digest*, 4 February 2000). Nevertheless, a broad alliance comprising the political left—such as human rights, labour and environmental groups—and the right—pro-life and Christian groups—has begun to rally support to oppose the agreement. Ohio Democrat Representative Sherrod Brown promised to 'make this [China's permanent MFN status] the biggest vote in the 106th Congress'. He also predicted that those who have supported the annual renewals of China's MFN status in the past may not support permanent MFN status for China. Given that granting China permanent MFN status has far reaching political implications, his prediction is probably right. Many believe that the United States will lose a major source of leverage over China once permanent MFN status is granted. China would have fewer incentives to cooperate with the United States in strategic issues and areas of global and regional importance, such as arms control and the Korean Peninsula.

The failed WTO Seattle meeting has had an adverse impact on China's WTO entry. Having opposed China's WTO entry on an anti-globalisation ground, labour and environmental groups have been further angered by China's open opposition to the inclusion of labour standards and environmental issues in the WTO talks. Following their disruption of the Seattle meeting, they are geared up to deny China's entry into the WTO ('After Seattle: a global disaster', *The Economist*, 11–17 December 1999:17–18). These groups are more confident than ever in blocking China's WTO entry given the networks and experience they have built over the past decade in protesting against various international organisations. Given that popular support for China's WTO accession is not very strong in the United States, the NGOs could play a critical role in the political balance.

Congressional and popular support for China's WTO entry has been severely undermined by allegations of Chinese campaign donations and espionage, including the alleged theft of US nuclear and satellite technologies. The recent arrest of Dr Wen-Ho Lee, who has been charged with illegally downloading classified documents and suspected of spying for China, has publicised the issue, further increasing the tension between China and the United States. China's public comments have only caused the matter to escalate into a diplomatic issue.

The upcoming US presidential elections are not conducive to a positive vote on China's accession to the WTO. Although the presidential candidates have declared in-principle support for the Sino-US WTO Agreement, it is not an issue that any candidate would like to push hard as there is probably little gain from doing so. Some believe that trade unionists are planning to use their leverage over Vice President Al Gore to force their hand in the issue.²² It is certainly unpopular to be seen as soft on China.

The presidential elections in Taiwan also carry a risk. Many members of US Congress are reluctant to consider China's WTO entry before China's reaction to the outcome of the 18 March 2000 election can be fully gauged. Although events have remained relatively calm so far, should China respond to the outcome more radically in the long term, as it did in 1996, the opposition to its WTO entry in Congress will certainly grow. Any serious deterioration in the relationship across the Taiwan Strait could put off China's WTO entry. The Taiwan Security Enhancement Act, which passed the US House of Representatives in early February 2000, could be an immediate threat to the Sino-US WTO Agreement if it passes the Senate as well and is not vetoed by President Clinton.

There is one factor which might help China when Congress votes. If China continues to stick to its non-devaluation commitment, its trade deficit with the United States may decline. This may happen because of increased competition in the US market from Asian Crisis countries which have experienced substantial real depreciations. China, of course, has paid a price for this, with slower growth, increases in unemployment and declining competitiveness (Yang and Tyers 2000).

China's National People's Congress (NPC) also has to ratify an overall accession agreement. Given the one-party nature of the Chinese political system, it is likely that an accession deal as reflected in the Sino-US agreement will pass the NPC, even though open opposition to such a deal will be the strongest ever in China. Failure to pass the deal would be a big blow to the Chinese political system, and it is unlikely to happen at this stage.

Conclusion

China's accession to the WTO is in the interests of both China and its major trading partners, even though earlier entry under the GATT before the Tiananmen incident may not have been in the best interests of China and world trading system. The progress of the accession negotiations has not been dictated by welfare considerations of the nations involved. It has been influenced largely by interest groups in both China and its trading partners, especially the United States. The strategic rivalry between China and the United States following the collapse of the Soviet Block has caused great tensions in virtually every aspect of the relationship. The WTO accession issue has become intertwined with these other issues. Once the issue gained its own political life, a major shock was needed to break the deadlock. Ironically, the bombing of the Chinese Embassy in Belgrade in May 1999 seems to have provided an impetus to the improvement of the Sino-US relations and a breakthrough to the accession negotiations.

The Sino-US WTO Agreement should set China on the path to a fully market-based economy. Despite its weaknesses in reducing some tariffs and potential difficulties in implementing the deal, the package will benefit China as well as China's trading partners. The risk the agreement carries lies in the opening of the banking sector. It could cause a major disruption or even a crisis in China's financial sector if sufficient reform is not undertaken in the fragile financial sector and the non-performing SOE sector. Another risk is that the special safeguard stipulated in the agreement will set a precedent for discrimination against transitional economies under the auspices of the WTO. Such discrimination can only be justified in the transition period, and anything beyond this is not consistent with GATT principles.

The fight over China's WTO entry is not yet over. Apart from formalities in Geneva and the upcoming vote in Washington, there are several obstacles on the road to China's WTO membership. The development of the relationship across the Taiwan Strait is particularly important. Any serious setback following the Taiwan presidential elections held on 18 March 2000 could cause a deterioration in overall relations between China and the West and hence the WTO accession process. Short of these serious setbacks, it will only be a matter of time before China becomes a WTO member, and with it, Taiwan too.

Notes

- 1 Much of the agreement in November 1999 was already in the offer that Chinese Premier Zhu Rongji presented to the Clinton Administration in April that year when Zhu visited the United States without reaching an agreement with the Clinton Administration. See the USTR Press Release at WWW.USTR.GOV/releases/1999/04/99-34.html.
- 2 See Mai and Lou (1999) and Wong (1999) for a detailed summary of the agreement.
- 3 In the April 1999 USTR Press Release, it was claimed that China had agreed to implement the APEC Early Voluntary Sectoral Liberalisation initiative (EVSL). This was not confirmed in the White House Summary of the November Agreement.
- 4 It is not clear that primary commodities other than agricultural commodities can be traded and distributed by US firms.
- 5 It is not clear from the White House Summary to what extent foreign equity participation in distribution is allowed.
- 6 China's Central Bank Chief, Dai Xianglong, apparently believes that market opening in the banking sector will force Chinese banks to improve their efficiency rapidly enough to avoid any major problem. Dai's comments were in response to the concern that WTO accession could prompt a banking crisis in China. <http://www.chinaonline.com/issues/two/currentnews/open/b2-99120307.asp>
- 7 Even though almost all studies conclude that China will benefit from accession to the WTO, a recent USITC (1999) study reports a small negative welfare effect if the growth effect of China's April offer is not considered. This is due to a large adverse terms of trade impact on China which, in turn, is a result of low trade elasticities assumed in the model used in the study. Any modelling exercise such as this will inevitably miss the benefits of institutional changes arising from a more open Chinese economy and society.
- 8 A recently publicised case of smuggling in Xiamen City allegedly involved senior ministers and customs officials. The value of the goods smuggled was reportedly 80 billion yuan (*Huadong Shibao*, 9 December 1999:15).
- 9 This will of course not offer much immediate help to the miserable state-owned enterprises in the textile industry. Much of the problem lies in the inefficiency of the state sector as well as import restrictions in industrial countries.
- 10 The deep division at the failed Seattle WTO meeting between developing and developed countries over the labour and environmental issues highlights the importance of China's participation in future WTO negotiations.
- 11 It is conceivable that some net exporters of textiles and clothing and net importers of agricultural commodities may lose as China's WTO accession will eventually lead to an end to MFA restrictions on its exports and increased agricultural imports by China may push up world prices somewhat. All these are likely to happen in the long run. Given that China will face special safeguard protection in textiles and clothing for four years after it will have been phased out for other developing countries, these countries are likely to be beneficiaries of prolonged restrictions on China.

- 12 For broad comparisons among countries based on the PPP approach, see Summer and Heston (1991).
- 13 It is true, though, that the goods China exports tend to lead to greater structural adjustment in industrial countries than those from high income countries, as labour-intensive manufactures are more likely to be in the domain of inter-industry trade rather than intra-industry trade.
- 14 By then, of course, China would undertake more intra-industry trade, which would lead to less adjustment pressure than inter-industry trade, which dominates Chinese trade at present.
- 15 Australia and the EU have recently recognised China as a transitional economy and its anti-dumping charges will be assessed on an enterprise by enterprise basis.
- 16 The industry has maintained a high profile in its campaign against the removal of US quotas on Chinese textile and clothing exports. They alleged that China's WTO accession would cost the US textile and clothing industry up to 154,000 jobs and up to US\$12 billion. After the signing of the Sino-US WTO Agreement on 15 November 1999, the Director of International Trade at the American Textile Manufacturer's Institute, Charles Breman, said: 'We're also very disappointed and very angry about the provision in the agreement which allows China to escape all of its quotas after merely five years of membership in the WTO' (cited in Kit Marlow, China undeserving of favourable textile concessions, says US textile group', China Online: <http://www.chinaonline.com/issues/wto/currentnews/secure/c9111632.asp>).
- 17 It may well be true that some prison and PLA-made products have entered the US market. However, it is unlikely that these products are sold under market prices because they would be sold in the domestic market. If these products are sold in the domestic market, it means that products produced by normal factories would likely be sold in the overseas market. Thus, banning prison-made products will not improve conditions in Chinese prisons. The pressure to improve these conditions should be applied directly if warranted. Incidentally, the United States also exports prison-made products.
- 18 One exception in the SOE sector is the textile industry. The removal of MFA quotas should improve their competitiveness.
- 19 Resignation in protest is not something Chinese officials would normally do because of its political and career implications. Thus, the rumour is unlikely to be true. Nevertheless, the spread of such a rumour may well be deliberate, expressing disapproval of Zhu Rongji's offer.
- 20 Contrary to wide media perception, it seems to me that China has not become more assertive in relation to the issue of territorial disputes in the South China Sea and Taiwan. One should remember that China was not hesitant to use force against Vietnam twice in the 1970s over the territorial disputes and the latter's invasion of Cambodia, while it has been more conciliatory in recent years. China has emphasised its priority for peaceful resolution of the Taiwan issue, in contrast to the rhetoric of 'liberation' of Taiwan prior to the 1980s.
- 21 The demand for a congressional vote has been strong. On 20 March 1997, for example, House Democratic Leader Richard Gephardt, joined with others to announce the introduction of legislation which would require a Congressional vote prior to the United States supporting China's entry into the WTO. He emphasized in a press release that 'China's entry into the WTO must have Congress' support'. <http://www.inetport.com/~gra/ChinaWTO.htm>.
- 22 It was reported that two days after the signing of the Sino-US agreement, President Clinton started to prepare selling the agreement. '[The President] is going to work very hard in the coming days and months to make the case for the benefits to American workers and business of the WTO agreement,' White House spokesperson Joe Lockhart said on 17 November 1999 at a press conference. http://www.chinaonline.com/issues/social_political/currentnews/secure/c9111823.asp.

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