



Woodrow Wilson
International
Center
for Scholars

*Asia Program,
Environmental Change & Security Project,
Project on America and the Global Economy*

China and the WTO

Domestic Challenges and International Pressures

Kent Hughes, Gang Lin, and Jennifer L. Turner





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Conference Agenda

CHINA JOINS THE WTO

DOMESTIC CHALLENGES AND INTERNATIONAL PRESSURES

December 12, 2001

5th floor Conference Room

AGENDA

Time	Topic	Speaker(s)
11:30 – 12:30 pm	Lunch/Keynote Address	Jeffrey A. Bader
12:30 – 12:45 pm	Coffee Break	
12:45 – 2:00 pm	State-Owned Enterprises under Siege	Dorothy J. Solinger Lawrence C. Reardon Mark A. Groombridge
2:00 – 2:15 pm	Coffee Break	
2:15 – 3:30 pm	WTO and the (r)evolution of Rural China	Qiren Zhou Baoqing Zhao Marilyn Beach
3:30 – 3:45 pm	Coffee Break	
3:45 – 5:00 pm	Keeping an American Eye on China	C. Richard D'Amato Calman J. Cohen Peter B. Hale

Executive Summary

Kent H. Hughes

Project on America and the Global Economy

On December 11, 2001, China became a formal member of the World Trade Organization (WTO). By joining the WTO, China took a major step towards economic integration with the world economy. In two decades, China has gone from the hermetic isolation of the Mao era to become a major force in many global industries.

DECISIVE STEP IN CHINA'S MODERNIZATION

WTO membership will accelerate the development of an open and globally competitive economy in China. In taking on WTO commitments, China's leaders opted to develop a strong economy that would be much more closely woven into the global trading system.

SIGNIFICANT OPENING FOR TRADE, SERVICES, AND INVESTMENT

Chinese WTO commitments include significantly cutting tariffs in manufactured goods, opening many services to various degrees of foreign investment, and following WTO codes on intellectual property and investment.

CHALLENGE FOR STATE-OWNED ENTERPRISES

Greater global competition will force China's inefficient state-owned enterprises to add to the millions of workers left unemployed by previous reforms. Global competition will force China to merge, privatize, or close 75,000 inefficient state-owned enterprises. China faces a key problem in adjusting to change while creating enough new jobs for displaced industrial and rural workers.

TRANSFORMATION AND OPPORTUNITY IN RURAL CHINA

China is sharply reducing (to an average of 14 percent) the agricultural tariffs of most interest to the United States. Increased imports of grains will displace Chinese farmers but also will open up opportunities to shift to higher value added crops such as fruits and vegetables. To turn challenge into opportunity, the Chinese government will have to create secure land

tenure and complement individual effort with key investments in infrastructure.

MONITORING AND SUPPORTING WTO COMPLIANCE

The WTO, the U.S. government, and the private sector will be monitoring China's compliance with its WTO obligations. There will be an effort by all parties to help with compliance rather than an early resort to formal dispute settlement by the WTO.

CHINA, U.S., AND THE FUTURE

With WTO membership, China will develop even closer ties with the United States and other major industrial countries. The still unanswered questions are whether closer economic ties will spill over into geopolitical cooperation and greater progress on democracy and human rights.

Introduction

Kent H. Hughes

Project on America and the Global Economy

On December 11, 2001, China became an official member of the World Trade Organization (WTO). Membership marked another major step by the Chinese leadership towards deepening free market reforms. Over just 21 years, China has moved from the isolation of the Mao Zedong era to become more outward looking and more integrated with the global community.

Exports, global finance, and a growing reliance on markets were not the early goals of the Chinese Communist Party. Since the Communists came to power in China in 1949, the Chinese people have lived through a series of social and economic experiments, which brought momentous change and periods of turmoil. The collectivization of agriculture and the creation of rural communes created an inefficient state grain bureaucracy that stifled innovation and productivity. Mao's Great Leap Forward and his experiment with backyard steel production both foundered on economic reality. These radical economic experiments helped trigger a famine in which millions died. Debates over the direction of the revolution and splits in the party leadership led Mao to launch the Cultural Revolution in which China lost a decade of development and a generation missed its chance at education.

In the late 1970s, Deng Xiaoping initiated economic reforms that opened China's economy to the world market. His dictum that it did not matter whether the cat was black or white only if it caught mice, presaged the reemergence of a free market and a gradual loosening of social restrictions. As China opened up to the world, the years of economic isolation and stagnation were apparent. Almost all Chinese wore the traditional blue or gray Mao jacket, few consumer goods were available, and state-run enterprises were models of inefficiency. Instead of cars, the wide boulevards of Beijing were dominated by the quiet whistling sound of thousands of bicycles.

China's long march to WTO membership started in 1986 when China first expressed an interest in joining the General Agreement on Tariffs and Trade, the predecessor to today's WTO. Over the following decade and a half, China became a major global exporter and a magnet for foreign

Coastal China is a reality that is full of economic promise, where Chinese industries are moving up the value chain from silk and shoes to semiconductors and software.

direct investment. China will be a major economic force in the WTO, for it is the third largest country by geographic size, has one of the world's largest economies, and, at 1.2 billion, the world's largest population.

Today, China has been transformed. From Beijing in the north along the coast to Guangzhou in the south, China is emerging as a major industrial power. The ubiquitous construction crane is but one sign of the explosion of urban growth. Mao jackets are dingy relics found only on the elderly, the rural poor, or the rare tourist. Fashionably dressed younger Chinese rush by, a cell phone at their ear, on their way to a private-sector job or the local discotheque. Evidence of the economy's openness to the world is apparent in the service as well as the industrial sector. Today foreign tourists to this modern China can lunch at KFC, shop at Wal-Mart and even have a latte at the Starbucks outlet in Beijing's Forbidden City.

It is this China that seems to offer the prospect of an enormous market for exports as well as domestic production. In the 19th century, the English dreamed of adding one inch to each shirttail in China as a way of "keeping the mills in Manchester spinning forever." A decade ago, Grahme Browning retold the same story in her *If Everybody Bought Just One Shoe*.

Coastal China is a reality that is full of economic promise, where Chinese industries are moving up the value chain from silk and shoes to semiconductors and software. While millions of urban Chinese consumers are already an important economic force in the world, rural Chinese lag far behind their urban cousins. The shift to more efficient agriculture and the closing of some state-owned enterprises (SOEs) have already created strains in Chinese society. Despite more than a decade of rapid growth, economists estimate that there may be as many as 150 million unemployed or partially employed Chinese seeking stable employment.

By assuring China access to the world's major markets, membership in the WTO offers this emerging economy enormous advantages. With that assured access, China will become an even more inviting site for foreign direct investors who are focused on export as well as Chinese domestic markets. In the American context, China is freed from the annual renewal of securing Normal Trade Relations status (formerly Most Favored Nation status). But there are challenges as well. On the one hand, a number of U.S. government agencies and congressionally created independent commissions will be carefully monitoring the progress of China in implementing the many requirements that come with WTO membership. On the other hand, greater international competition will accelerate changes in the state-owned enterprises and the agricultural sector. Further liberalization of the Chinese market should speed economic growth and, eventual-

ly, generate new jobs for the immense Chinese workforce. In the near term, however, WTO compliance may simply add millions more to the tens of millions already looking for work and exacerbate social instability.

In the wake of China's accession to the WTO, the Asia Program, the Environmental Change and Security Project's Working Group on Environment in U.S.-China Relations, and the Project on America and the Global Economy co-hosted a one-day Wilson Center conference titled *China and the WTO: Domestic Challenges and International Pressures*. During this conference, speakers focused on these two fundamental questions:

- The impact of WTO membership on China's state-owned industrial sector, its rural economy, and overall social stability.
- China's ability to comply with WTO strictures.

Jeffrey Bader, Assistant United States Trade Representative for China on **China's Accession to the WTO**

Edited by Kent H. Hughes

As Assistant United States Trade Representative for China, Bader was instrumental in helping take the final steps in representing U.S. interests as China joined the World Trade Organization (WTO). Prior to joining the Office of the United States Trade Representative (USTR), Bader served as Director of Asian Affairs on the National Security Council, as Deputy Assistant Secretary of State for East Asian and Pacific Affairs, and U.S. Ambassador to Namibia. His remarks at the Wilson Center conference are summarized below.

Bader put the overall significance of Chinese accession in several different categories:

- A decisive step in China's move toward market oriented modernization;
- The end to congressional debates over the annual renewal of normal trade relations (previously most favored nation) status with China;
- A dramatic opening of China's goods market;
- Broad Chinese acceptance of WTO standards on services, intellectual property and investment; and,
- A significant shift toward transparency and the rule of law in China.

DECISIVE STEP IN CHINA'S MODERNIZATION

China first expressed interest in becoming a member of the General Agreement on Tariffs and Trade (GATT) in 1986. China was emerging from a long period of relative isolation to join a number of major international organizations. Joining the GATT was, as Bader commented, "one more step in the alphabet soup" of organizations that China was intent on joining. Membership was not so much part of an economic strategy as it was a part of China's becoming a full-fledged member of the global community. By June 1989, a working party of the GATT was scheduled to meet in Geneva with the prospect of approving China's membership, a prospect that was delayed by the Tiananmen Square protests and their dramatic suppression by the Chinese military. While Chinese membership was

in abeyance, members of the GATT completed the Uruguay Round of multilateral trade negotiations. Bader noted that the Uruguay Round not only created the World Trade Organization as a successor to the GATT but also significantly raised the bar for any country seeking WTO membership.

China continued to seek GATT and then WTO membership but with a broader interest. In the 1990s, many inside China saw WTO membership as “a mechanism for transforming China’s economy, for making it a market economy, for making it an economy that could compete in the late 20th and 21st centuries.” The move towards membership in the WTO had the backing of key Chinese leaders and the strong support of the Chinese Ministry of Foreign Trade and the Economic Cooperation (MOFTEC). In practice, there developed a kind of tacit alliance between the Chinese modernizers and outside negotiators who were seeking greater access to the Chinese market.

In addition to strengthening China’s development of a competitive market system at home, WTO membership gives China WTO protection in entering all the world’s major markets. Bader expected that the assured access to global markets would create increased export opportunities. It would also make China an even more attractive target for foreign direct investors, who are focused on exporting from China as well as selling in China’s domestic markets. In Bader’s view, China’s membership in the WTO is an all but irreversible commitment to greater integration in the world economy.

PERMANENT NORMAL TRADE RELATIONS

Along with WTO membership, China also secured permanent normal trade relations status with the United States. Bader noted that the annual debates over trade relations had become a lightning rod for virtually every concern Americans have expressed about China. As China’s bilateral trade surplus has grown with the United States – approaching \$ 85 billion in 2001, more and more attention was paid to Chinese trade practices. But in addition to trade, the congressional debates often focused on human rights, the use of prison labor, the lack of a commitment to democracy, failed attempts to restrict the proliferation of key technologies and weapon systems, and a host of security issues.

While favoring further opening of the Chinese market, some in Congress were reluctant to lose the leverage they saw in the annual debate over trade. Others contended that the threat of Smoot-Hawley era tariffs was so draconian that it would never be used. Some in Congress also suggested that steady but less visible pressure might be more effective in deal-

China’s membership in the WTO is an all but irreversible commitment to greater integration in the world economy.

ing with China. Supporters of free trade also argued that development of a rule of commercial law in China would eventually spill over into the treatment of individual and political rights. Even if the prospect of imposing prohibitive tariffs was remote, U.S. exporters and investors generally favored eliminating that uncertainty by granting China permanent normal trade relations as part of securing WTO discipline over China's own use of trade barriers. In the end (in 1999), the Congress voted for permanent normal trade relations as part of China's joining the WTO.

EXPORTS TO CHINA

China's accession to the WTO marks a dramatic opening of the Chinese market. Bader noted that 1,000 pages of Chinese commitments to market opening can be found on the WTO's website (<http://www.wto.org/>) and a summary of them on the USTR's website (<http://www.ustr.gov/regions/china-hk-mongolia-taiwan/accession.shtml>).

Under the Chinese agreement for accession to the WTO, agricultural tariffs on the products of most interest to the United States will average 14 percent. Overall, tariffs of interest to the U.S. will fall to 7 percent. For goods involved in information technology, tariffs will disappear altogether in 2005.

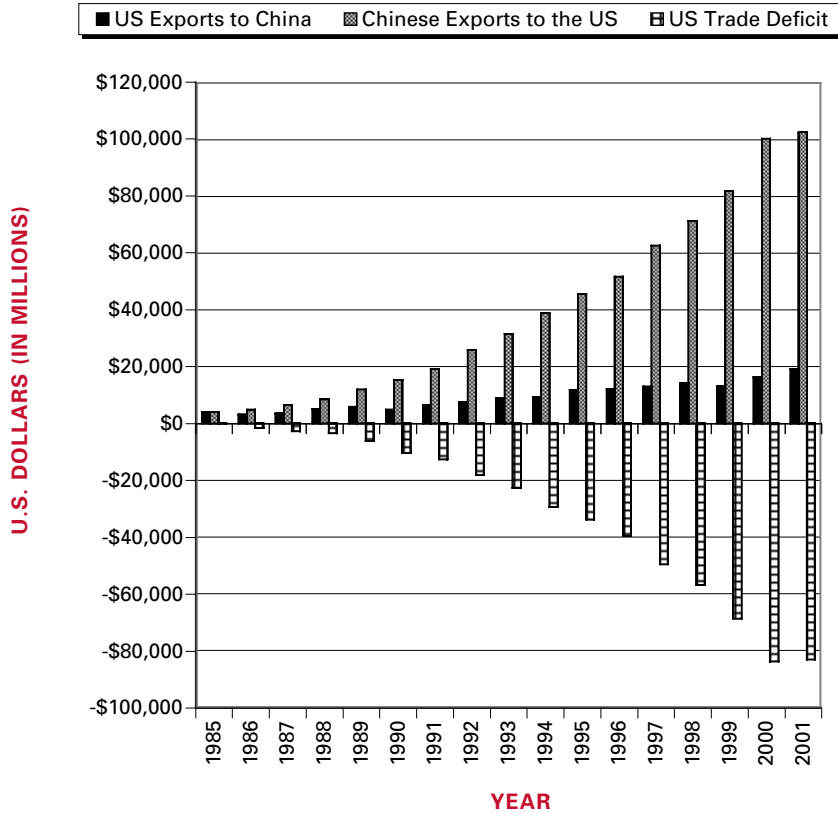
Bader pointed to the tariffs on IT related products as one of the benefits that came from the lengthy and detailed negotiations over Chinese WTO membership. The question of reduced tariffs on IT products had first been raised in the Asia-Pacific Economic Cooperation forum. China decided that the zero tariffs on IT would be in its interest. In Bader's view, China's commitment to phase out tariffs on IT products and equipment had already helped attract related IT investments from Taiwan.

BEYOND EXPORTS: SERVICES, INTELLECTUAL PROPERTY, AND INVESTMENT

Bader noted that China had agreed to an across-the-board opening on services. China will now allow varying degrees of foreign investment in insurance, banking, and securities. The full range of service openings extends from law firms to freight forwarders.

The negotiators also made considerable progress in securing the right of foreign investors to distribute their products within China. After three years, foreign companies can have wholly owned distribution networks in retail and wholesale trade and through commercial agents. The only exception left is for chain stores, and Bader stressed that they had negotiated a fairly narrow definition of what constituted a chain store. The right to

US AND CHINESE TRADE SINCE 1985



Source: US Census Bureau, Foreign Trade Division Data Dissemination Branch, Washington D.C. 20233

distribution networks would be phased in over three years – the first year allowing minority ownership, the second a majority stake, and the third full ownership.

China also agreed that foreign firms could do business in China without establishing a physical presence. There is change coming on the strictly domestic front as well. With WTO accession, China's many state-owned enterprises (discussed in the first panel of the conference) will have to make decisions on a commercial rather than a political basis.

Chinese accession also means that it will be required to abide by existing WTO codes on intellectual property and investment. Under the code for Trade Related Investment Measures, China cannot require offsets, foreign exchange balancing, or specific levels of exports as a condition for investing in China. Foreign products must be given the same tests and held to the same technical standards as domestic goods.

In agriculture, China actually went well beyond the current WTO requirements. China agreed to forego all export subsidies for agricultural

The agreement, Bader stressed, was not self-implementing. ... Bader again expressed his view that the Chinese would stick to the letter of quantifiable commitments such as specific tariff reductions.

products and accepted a cap on domestic subsidies that is lower than normally available to developing countries.

With Chinese membership in the WTO, the focus will now shift from negotiation to implementation. The agreement, Bader stressed, was not self-implementing. He noted the continuing negotiations with Korea, Japan, and others to secure full market access. Bader again expressed his view that the Chinese would stick to the letter of quantifiable commitments such as specific tariff reductions. He pointed to the services agreements as a field where written rather than numerical agreements were subject to interpretation and hence debate. Bader also noted the three hundred-plus paragraph narrative in the WTO Working Party report on Chinese WTO membership, which also would be subject to interpretation.

In some cases, Bader noted that China's lead negotiating agency, the Ministry on Foreign Trade and Economic Cooperation, worked closely with other agencies that had responsibility for banking or insurance. Those agencies had helped shape Chinese commitments in joining the WTO and could be expected to work for its implementation. In other cases, however, such as distribution, there was no single ministry that could speak for the millions of retail outlets in China. Local officials who were not part of the WTO process may well be the first to hear complaints from local shop owners. These local officials may raise questions and obstacles of their own.

To help monitor and encourage compliance, the Administration and the Congress have established a number of watchdog groups. (see summary of panel three below). Specifically, USTR is chairing an interagency group to monitor China's progress. Moreover, separate departments or government agencies are assigned to keep track of specific Chinese commitments. Each month the interagency group will meet to review progress toward compliance. In addition, the interagency group will review the concerns of American business and trade associations. Bader also mentioned a multilateral review established under the WTO that will result in a report each year for the first eight years after China's accession and then again on the tenth year.

WTO AND REFORM IN CHINA

Many China watchers predict that joining a rule-based organization like the WTO will have an impact beyond the strictly economic sphere. As a result of joining the WTO, the Chinese administration should become more transparent; for example, they will be expected to publish laws and regulations. Bader noted that China had already opened up proposed tariff

rate quotas for public comment. China is also developing a system of administrative review so that bureaucratic rulings can be appealed.

China will also be subject to the current WTO rules for dispute settlement. Although Bader and subsequent panelists expected early disputes to be settled between the various parties rather than through the WTO, the prospect of a formal dispute settlement process will help China adhere to its extensive WTO agreements.

Such requirements mean that WTO membership will significantly add to the forces of accountability within China. The presence of accountants and lawyers should help develop the rule of law as well as facilitating commerce. Bader speculated that the spreading rule of law would also contribute to a growing pluralism in the years to come. He also struck a positive note about China's role as a WTO member, noting that China was a forceful advocate for a new round of multilateral trade negotiations at the latest APEC meeting. Because of China's extensive WTO commitments on agriculture, he also thought China might push for the reduction or elimination of export and domestic subsidies in other countries.

In conclusion, Bader summed up the range of market opening commitments that China has made in joining the WTO. He noted that both the United States and China were very careful to guard their national sovereignty. China's decision to accept the review of sovereignty implicit in WTO membership was, he believed, a major step toward Chinese modernization and fuller integration into the world economy. At the same time, Bader stressed that the agreement was not self-implementing. WTO members would need to work with China to achieve the full benefits of WTO membership.

State-Owned Enterprises under Siege

Gang Lin

Asia Program

The most dramatic change in China's economic system is the melt-down of the colossal and inefficient state-owned enterprises (SOEs), the backbone of this country's socialist economy. Encouraged by the success of rural reforms and an open-door policy, Beijing began to transform SOEs in 1981, with the experiment of the "profit-contracting system" in some cities. Under this system, the government contracted SOEs to individuals, who turned over a certain percentage of their profits to the government. Two years later, this practice developed into a system of replacing profit remission with tax payments (*li gai shui*). Since 1992, greater efforts have been made to transform state-run enterprises into state-owned, but corporately or privately run enterprises (*guoyou mingying qiye*) through share-holding reforms. Beijing's major reforms to SOEs include:

- Making a distinction between government administration and business operation;
- Establishing a modern enterprise system in several hundred giant SOEs under the direct control of the State Council;
- Encouraging the merging and bankruptcy of medium-sized SOEs; and,
- Privatizing small SOEs through restructuring, contracting, joint stock holding, merging, leasing and selling.

In 1993, the 8th National People's Congress amended the PRC constitution and promulgated a new Enterprise Law to legalize these strategic changes. Meanwhile, the notion of the "socialist market economy" was officially endorsed by the state during the Party's 14th Congress in 1992, replacing the previous conceptual cohabitation of the "socialist commodity economy" and "socialist planned economy."

This strategy of trickling down market and property rights reform within the symbolical framework of socialism not only neutralized conservative political opponents within the Party, but also contributed to China's continued and stable economic growth during the important transition. The trade-off, however, is the slow pace of China's marketization and privatization.

Beijing's dual policy of controlling big SOEs while leaving a free hand for small ones reveals its reluctance to promote large-scale privatization. Because of ideological constraints, the Chinese leadership's efforts at reforming loss-making SOEs achieved only marginal results during Deng Xiaoping's era. The contribution of SOEs to China's gross value of industrial output decreased from 65% in 1985 to 28% in 1998, while SOEs still employed more than 40% of urban workers and accounted for the lion's share of China's fixed asset investments and financial resource allocations.

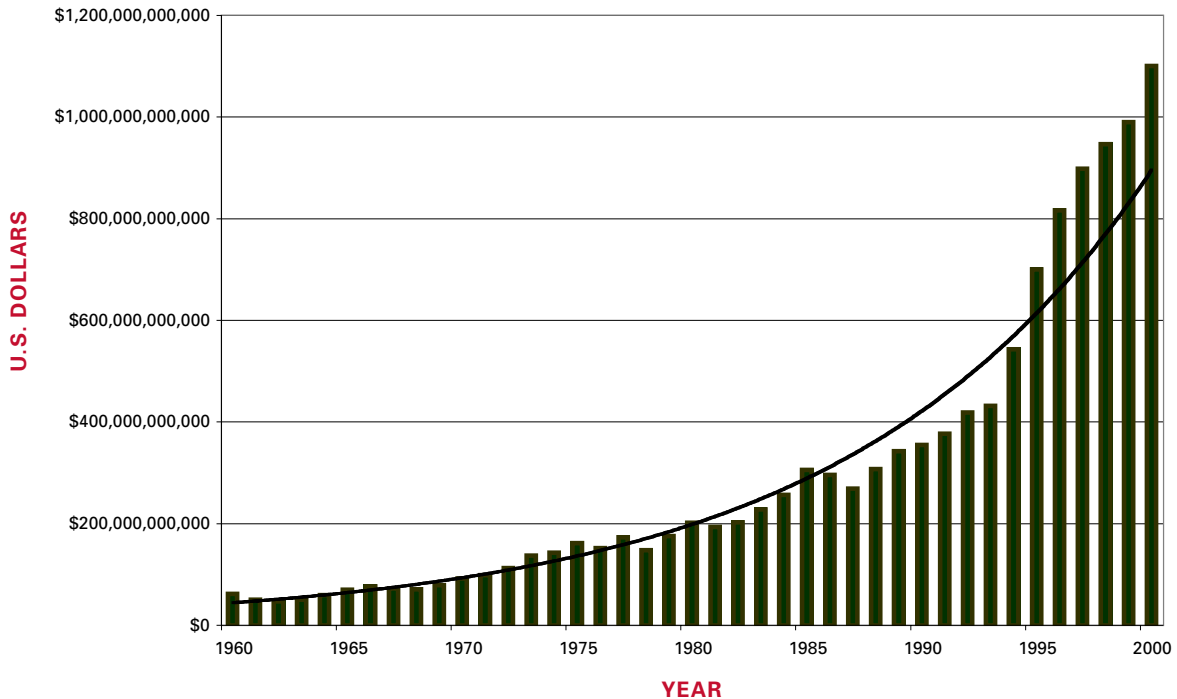
Post-Deng reformers perceive China's entry into the World Trade Organization (WTO) as both a great opportunity for accelerating economic reform and growth, and a threat to China's industrial structure and financial security. In the past five years, China's SOEs have continued to shrink, with several million workers being laid off each year. Meanwhile, the urban private sector has increased its number of employees dramatically. Swift and stable economic growth has turned China into one of the world's largest economies and sharply raised the per-capita income of the average Chinese. The benefits of growth, however, have not been evenly spread over the country, and there is a growing economic gap between the eastern coastal areas and the western hinterlands.

Chinese reformers hope that, with China's entry into the WTO, intensive international competition will accelerate reforms of the country's money-losing state enterprises and create new industries and jobs. Although China's service industries—from banking and insurance to the Internet—and capital-intensive sectors are generally ill-prepared to compete on the world stage, they believe China will move substantially toward enlarging its comparative advantage by developing its labor-intensive sectors as well as new technology industries. It is unclear, however, to what degree the benefits for certain industries will offset bankruptcies and layoffs in other industries.

Will China's WTO membership finally solve the problem of its inefficient SOEs, or strike the death knell for these incurable ventures? Will China's membership in the WTO result in economic disorder and social chaos, or accelerate China's ongoing reforms? How does Beijing evaluate the benefits and costs of its membership in the WTO? How will Beijing tackle the issue of increasing urban unemployment in the wake of its admission to the WTO? Who within China will be the economic and political winners and who will be the losers? The panel on state-owned enterprises addressed these and related issues with a focus on the implications of China's WTO membership for the country's economic development and social stability.

Post-Deng reformers perceive China's entry into the World Trade Organization (WTO) as both a great opportunity for accelerating economic reform and growth, and a threat to China's industrial structure and financial security. In the past five years, China's SOEs have continued to shrink, with several million workers being laid off each year.

CHINA'S GDP SINCE 1960 IN CURRENT U.S. DOLLARS



Source: World Bank WDI 2001

Dorothy J. Solinger of the University of California at Irvine highlighted the negative impact of China's WTO membership on the country's rampant unemployment. According to Solinger, the rosy picture of a "win-win" deal between Washington and Beijing laying the groundwork for China's entry into the WTO turns bleak when one considers the plight of the 45 to 60 million former state-employed workers who have been left with few economic opportunities. Solinger challenged five optimistic assertions about China's entry into the WTO:

- 1) More jobs will be gained than lost;
- 2) The pain will be short term, and the problems will all be solved in the longer term;
- 3) Chinese consumers will benefit from more choice and cheaper foreign goods
- 4) Export-oriented sectors, such as textiles, will benefit; and,
- 5) The tertiary sector and privately-owned enterprises will provide places for the unemployed.

Solinger observed that several of Beijing's efforts to help the unemployed have yet to bear much fruit. Started in 1995, the national government's Reemployment Project has targeted only a fraction of the unemployed. With entry into the WTO and heightened international competition, millions of better-placed citizens will rise to the challenges of a more open and exposed market economy. However, millions of less fortunate workers will sink further into poverty.

Wilson Fellow **Lawrence C. Reardon** of the University of New Hampshire agreed with Solinger that China's WTO accession would force the closure of many SOEs, thus ruining the livelihood of millions of workers. It is precisely these dangerous "transaction costs," however, that are most valued by Chinese elites promoting a long-term modernization agenda. Stymied by conservative elites, state bureaucracies, and regional interest groups over the past several years, reformist leaders hope to use the economic crisis created by international competition to merge, privatize, and close China's 75,000 inefficient SOEs. According to Reardon, China was not forced into the WTO by some unseen hand of globalization. Rather, reformist elites consciously decided to give up a degree of national sovereignty, hoping to exert global economic power and to double the country's economy to \$2 trillion within ten years. Still, reformist elites face obvious dangers in using WTO accession as a catalyst to marketization. It is unclear whether the lagging inland Chinese economy will be able to absorb the onslaught of foreign competition, especially after direct and non-direct aid to SOEs are phased out.

In his commentary, **Mark A. Groombridge** of the U.S. Department of State argued that China has no choice but to integrate itself into the world economy. According to Groombridge, both China's inefficient SOEs and the resulting unemployment problem are the legacy of the Mao era's command economy. Despite severe social disparity and dislocation, the Chinese population's living standard has improved in general, thanks to the economic reforms of the past two decades.

This panel stressed both the dangerous repercussions and the huge opportunities that Chinese SOEs face in the wake of China's entry into the WTO. As Reardon put it, Beijing is gambling on international competition as the death knell of the command economy, and that this outside challenge will change China for the better. China's future development hinges upon whether Beijing can appropriately reconcile the tension between economic efficiency and social stability, an old theme within the new context of China's economic transition.

Stymied by conservative elites, state bureaucracies, and regional interest groups over the past several years, reformist leaders hope to use the economic crisis created by international competition to merge, privatize, and close China's 75,000 inefficient SOEs.

(R)evolution of Rural China

Jennifer L. Turner and Sun Liang

Environmental Change and Security Project

Joining the World Trade Organization is both a continuation and a breakthrough in China's decades-long process of reforming and integrating its economy into the global market. An examination of the challenges facing China's rural sector as the country enters the WTO highlights the complex interactions between global economic integration and domestic policy dynamics. The three speakers on this panel stressed that while China's accession into the WTO offers some benefits for rural residents and agricultural production, stable and sustained rural prosperity will depend much more on the ability of the Chinese government to complete land, labor, and financial market reforms while adequately enforcing natural resource protection laws.

GROWTH, CHANGE, AND POVERTY IN RURAL CHINA

For over 50 years China's agricultural sector has been heavily taxed to finance the country's intensive industrialization program. Decollectivization of agricultural production and the return of family farms in the 1980s heralded China's broader national reform program and created opportunities for greater rural prosperity. These rural reforms stimulated both growth and diversification of crop production besides releasing many from agricultural labor. By 1997, however, growth rates for both rural income and productivity had stagnated. Since the 1980s, roughly 150 million agricultural workers have left farming, several million of whom migrated to the lower tiers of the urban service sector. Despite the reforms and mass migration to the cities, rural areas, home to 70 percent of the Chinese population, capture only 30 percent of the country's GDP. Income for farmers rose barely 1.8 percent in 2000, the lowest increase since the beginning of reforms 22 years ago. It is perhaps not surprising that the major root of the discontent in rural areas is unrelieved poverty. In fact, in its 2000 year-end review of domestic affairs, the Communist Party leadership singled out rural unrest as the biggest threat to its rule. In internal talks, President Jiang Zemin gave top priority to three overriding tasks in the countryside: boosting agricultural production, increasing farmers' incomes, and maintaining stability in villages.

THE NEED FOR STABLE LAND TENURE

In light of the rapid expansion of industrial and service sectors, the trend of a declining share of agricultural value-added in the national economy is likely to continue in the coming decades. It is therefore crucial for the Chinese leadership to create new sources of income for China's rural population. Besides moving more rural laborers out of agriculture into industrial and service sectors, the government needs to create a new land use system that will enable rural residents to share the benefits of rapid industrialization. Currently, rural residents rent the land from the state and easily lose user rights when local governments opt to lease farmland to industrial or urban development companies.

THE POTENTIAL SHIFT TO HIGH VALUE, LABOR INTENSIVE CROPS

Since abundant labor supply remains an important comparative advantage for China's rural sector, under the WTO farmers could enjoy income gains through the development of labor-intensive, value-added farming activities (e.g., vegetables, horticulture, and organic farming). However, such a transformation in agricultural production patterns must be supported by the creation of a sound market-based distribution system. Specifically, four types of market mechanisms are necessary to help farmers break into new niche markets:

- 1)** An open and competitive agricultural product market;
- 2)** An integrated labor market;
- 3)** A mature land market with clearly-defined property rights; and,
- 4)** A competitive financial market for more efficient resource allocation.

THE WTO AND RURAL CHANGE

It is in this context of half-completed rural economic reform that China now enters the WTO. The main components of the WTO agreements that will affect China's agricultural sector include:

- 1)** Elimination of sanitary and phytosanitary barriers on U.S. exports of wheat, citrus, and meat;
- 2)** Elimination of China's subsidies to agricultural exports;
- 3)** Adoption of a tariff-rate quota (TRQ) system for grain imports;

- 4) Reduction of tariffs on agricultural products to well below 20 percent for major agricultural imports from the United States; and,
- 5) Liberalization of state monopoly and allowing private companies to engage in agricultural trade.

The fear in some rural areas is that the WTO will only attract funds to already wealthy areas, leaving poor, interior regions to lag further behind.

The impact of the WTO on agricultural production and the lives of rural residents initially will not be as great as the immediate changes the agreement will have on the industrial sector. Previous agricultural reforms already have cut subsidies to agriculture, so China's WTO commitment to decrease agricultural subsidies will have little impact. Increased grain imports are expected to enable many of China's farmers to shift from low-profit crops, such as wheat, corn, rice, and cotton, to the more lucrative and less state-controlled fruit, vegetable, and meat markets. For example, WTO's tariff-cutting measures are expected to boost China's vegetable export market by as much as five percent a year. Certainly, rural workers will benefit if they find employment opportunities in these new niche markets or in agricultural production sectors that thrive as a result of WTO's lower restrictions for China's export goods.

THE WTO AND RURAL REFORMS IN CHINA

Marilyn Beach from the National Committee on U.S.-China Relations stressed that while allowing farmers to change from food-security crops to higher value crops may raise rural incomes, the economic impact of such shifts would vary widely throughout the country. In less prosperous areas—such as wheat, maize, and soybean growing regions, as well as forest and timber producing areas—the effects of the WTO on the rural quality of life will depend on how successful poverty alleviation efforts are in the countryside. The fear in some rural areas is that the WTO will only attract funds to already wealthy areas, leaving poor, interior regions to lag further behind.

Many of the rural structural reforms needed in China are not directly tackled in the WTO framework. In fact, many of the potential gains of WTO membership in the agricultural sector—particularly the long overdue liberalization of the state monopoly of grain production and permission for private companies to engage in agricultural trade—can be fully realized only when new rules of fair and open competition are combined with sustainable investments in agricultural technology, market expansion, and education. China's farmers also need access to a greater share of the benefits of rising land values.

The rural people who may be displaced by the WTO will need access to information and training on how markets work. The Chinese govern-

ment therefore needs to put a premium on investments in education and technical training on how domestic and international markets function and on how to promote post-harvesting technologies such as food processing, packaging, and transportation. While setting up and funding such training programs for rural farmers would be challenging, such capacity building activities (as well as agricultural environmental investments) are exempt from WTO restrictions on subsidies. **Zhou Qiren** from Beijing University noted that a potential solution to the dilemma of abundant labor supply and low productivity would be for the government and business communities in China to create a contract-based system that links modern, economy-of-scale agricultural businesses with the labor-intensive farmer households.

IMPACT OF THE SANITARY AND PHYTOSANITARY AGREEMENT

In his presentation, **Zhao Baoqing** from the Chinese Embassy in Washington, DC highlighted the Sanitary and Phytosanitary (SPS) Agreement's (part of China's WTO accession packet) important effects on the adequacy of animal, plant, and human health standards in China's agricultural sector. The SPS agreement restricts China from potentially trade-distorting inspection and border control measures and imposes higher transparency criteria. These requirements pose challenges to the country's limited technical and administrative capacities to protect China's farmlands and pastures from alien (including genetically-modified) products and species while complying with international SPS norms. Moreover, Chinese farmers, especially those in less developed inland areas, are not equipped with adequate knowledge or technical support to identify and combat these risks. Notably, these gaps in capacity are addressed in the 1999 U.S.-China Agricultural Agreement. This bilateral agreement provides the framework for bilateral cooperation on training and information sharing on environmental protection issues in the agricultural sector—ranging from measures to improve pest and disease management to sustainable irrigation and land use.

LOCAL GOVERNMENTS LACK RESOURCES FOR RURAL REFORMS

While Beijing is committed to fulfilling WTO requirements, domestic policy dynamics potentially hinder rural areas from taking advantage of WTO-related adjustments. Specifically, over the past twenty years the central government has decentralized by granting considerable administrative

Local governments in China face daunting challenges in improving the livelihood of rural inhabitants, 15 percent of which are unemployed and underemployed.

and economic powers to the provincial and sub-provincial governments. While they possess the authority, local governments often lack sufficient resources (and incentives) to carry out the necessary structural reforms and policies that could help the agricultural sector. In short, local governments in China face daunting challenges in improving the livelihood of rural inhabitants, 15 percent of which are unemployed and underemployed. Prior to the reform era, rural and urban inhabitants had little freedom of movement due to a household registration system that tied them to their workplace. Throughout the 1980s and 1990s rural citizens have been moving to urban areas without being granted the legal right to live in cities. This meant they faced difficulties in acquiring housing and access to other urban social services. The current proposed household registration system reform to loosen registration requirements in cities may accelerate the already significant trend of rural unemployed migrating to cities and further straining urban infrastructure.

Ultimately, difficult policy reforms in rural areas will be key to ensuring a smooth transition for farmers adjusting to more open markets and moving successfully to new crops. For instance, the government has made tentative legislative moves to redefine rural property rights to encourage more efficient and sustainable land use and conservation. Economic welfare of the farmers can only be achieved when the farmers themselves have a bigger say in the allocation and use of rural resources in such forms as farmers associations. However, the increased fiscal burden on local governments, particularly in poor inland regions, hinder their ability to institute the needed agricultural reforms, especially investments in infrastructure, sustainable production and conservation.

The WTO has outgrown the simple formula of numerical free trade. In November 2001, at the same WTO ministerial meeting where China was formally accepted as a member, the WTO put new emphases on the environment and development programs in the Organization's agenda. While it is difficult to predict how tariff reductions in primary commodities such as timber and minerals will affect China's rural sector, it is clear that domestic policy choices in the changing international environment may more directly and more profoundly impact the livelihood of China's rural population in the coming decades than the fulfilling of the WTO agricultural agreements.

Keeping an Eye on China

Kent H. Hughes

Project on America and the Global Economy

In 2000, the prospect of China's accession to the WTO triggered an extensive debate in the U.S. Congress. To support China's application for membership, the Congress debated and eventually approved the trade agreement with China and the granting of permanent normal trade relations (PNTR) status. This ended twenty years of debate on China's trade status with the United States. Previously, under the Jackson-Vanik (adopted in December 1974) provision of U.S. trade laws, the Administration had to request and the Congress not disagree on an annual waiver awarding normal trade status. Although the provisions were originally targeted at Soviet restrictions on immigration, the language of the statute encompassed China and a number of other centrally planned economies. The question of NTR was more than a shift in labels, for lacking NTR meant a country would have to pay the onerous tariff rates originally established by the Herbert Hoover era Smoot-Hawley tariff.

The yearly debates on granting normal trade relations to China touched on questions of U.S. national security, human rights, and the development of Chinese democracy. For some in Congress, the annual debates were viewed as a way to pressure the Chinese leadership over human rights, religious freedom, and the failure to adhere to agreements limiting the export of key weapons-related technologies. For these Members of Congress, granting PNTR would eliminate a key point of leverage with China. Much of the debate also focused on the promise and challenge of the Chinese market.

CURRENT U.S. TRADE WITH CHINA

In the decades since China began to open its economy to overseas trade and investment, China has become an active commercial partner of the United States. Investment and technology flowed from the United States and other industrial countries into China. Two-way trade also has grown substantially with American capital equipment, aircraft, and high technology goods going to the Chinese market while a growing array of largely Chinese consumer goods are destined for the American market. The bilat-

eral trade balance is decidedly in China's favor. At \$ 85 billion, China's trade surplus with the United States accounted for almost 25 percent of the \$ 346.3 billion trade deficit in 2001. This increasing deficit was a key factor cited by congressional opponents of granting PNTR and allowing China's entry into the World Trade Organization (WTO).

THE COSTS OF WTO COMPLIANCE

Preceding sections in this conference report summarize the findings of separate panels on the expected impact of WTO membership on rural China and China's state-owned enterprises. Beyond structural changes in the economy, China has committed to lowering tariffs, expanding the rule of law in commercial matters, and developing transparent, WTO consistent regulations. How to monitor and encourage China's progress in these areas is of keen interest to U.S. policymakers and businesses.

MONITORING CHINA'S COMPLIANCE

WTO compliance is a major challenge for China and is, at the same time, critical for America and for other countries seeking access to Chinese markets. The WTO itself has formed a group that will issue an annual report on Chinese compliance with WTO rules for the first eight years and then again on the tenth anniversary of Chinese accession. The U.S. Congress has charged a number of official bodies with the responsibility of reporting on trade-related developments in China. The monitoring and reporting activities of the following organizations is seen as key in ensuring Chinese compliance to its WTO commitments:

- *The United States Trade Representative Office* will provide periodic reports on Chinese compliance with WTO requirements.
- *The General Accounting Office (GAO)*, widely known as the watchdog for the congressional branch, has established a separate unit to track Chinese WTO compliance.
- Congress established two independent commissions to monitor China's progress on trade, human rights and other matters. *The U.S.-China Security Review Commission* will focus on trade and national security questions. The separate *Congressional-Executive Commission on China* (often referred to as the Levin Commission) will devote considerable attention to human rights while also monitoring compliance with WTO strictures.

MISSION OF THE U.S.-CHINA COMMISSION

C. Richard D'Amato provided an overview of the mission of the U.S.-China Commission, a permanent body created by the Congress in 2000. Commission members already have visited China and have planned a series of hearings before their first report to the Congress in mid-2002. Chairman D'Amato listed five key questions that would define the Commission's work:

- 1) Does China have the will and the means to comply with WTO requirements?
 - 2) Does WTO compliance risk triggering social and political unrest?
 - 3) Will China promote democracy?
 - 4) What is the impact of Chinese compliance on the U.S. economy including an assessment of the winners and losers from expanded economic ties?
 - 5) How will Chinese WTO membership and compliance affect other Asian countries including Taiwan?
- *Will China comply?* D'Amato thought that the current Chinese leadership was intent on meeting its WTO obligations. This was a sentiment echoed by other panelists as well. In D'Amato's view, the more reform-minded Chinese leaders see WTO membership as a way of forcing the country to move toward a market economy while still maintaining tight control from the center. He did think that the Chinese government was prepared for many of the challenges arising from WTO compliance, particularly the risk of instability.¹
 - *China has the will, does it have the way?* It was less clear whether the central leadership had the means to assure full compliance. There is still a lack of transparency in making and applying laws and regulations. In many cases not even the Chinese text is available. The Chinese leadership also faces the challenge of strong provincial governments and vibrant regional economies. Implementing the WTO will demand considerable political skill as well as technical expertise to rewrite or create needed regulations.
 - *The U.S. role.* D'Amato thought there was an important role for the United States government in helping China to comply with the WTO. Technical assistance is one obvious area where the United States can provide assistance. The United States will also have to be aware that too

D'Amato thought that the current Chinese leadership was intent on meeting its WTO obligations.

Cohen saw a twin mission for American business—securing Chinese compliance with the WTO and promoting a constructive role for China within the WTO.

sudden a change could overwhelm China's good intentions. D'Amato thought that bilateral discussions and some economic confidence-building measures also could be important. Early resort to the formal WTO dispute resolution process could be a mark of failure.

U.S. BUSINESS AND CHINESE COMPLIANCE WITH THE WTO

As the president of the Emergency Committee on American Trade (ECAT—a thirty-year old organization composed of major U.S. exporters), **Calman Cohen** gave an American business perspective on Chinese compliance with the WTO. Cohen saw a twin mission for American business—securing Chinese compliance with the WTO and promoting a constructive role for China within the WTO.

- *Opportunities for U.S. business:* Cohen noted that Chinese membership in the WTO was the product of fifteen years of bilateral and multilateral negotiations and China's participation holds great potential for American business. Notably, U.S. and other businesses are in the process of creating global webs of production in which China will import and export components that are part of larger, global value chains.
- *U.S. business helps with Chinese WTO compliance:* Many of China's commitments under the WTO will be phased in over a number of years, which will provide time for the Chinese government to change laws and reform institutions. Cohen saw an important role for U.S. business in providing advice to China on how best to meet various WTO requirements. In the past China has not always fully met its trade obligations and also has missed technical deadlines. Moreover, while disagreements over the nature and pace of change are almost inevitable, Cohen stressed that in choosing to dispute specific cases, the U.S. business community needs to be strategic in its thinking and keep the long-term relationship in mind. He did not anticipate any early rush to use the formal WTO dispute mechanism vis-à-vis China.
- *Taking the long view:* Cohen also urged the U.S. government and business community to adopt a long-term perspective in monitoring Chinese compliance with the WTO. China sought and achieved WTO membership because of the benefits it offered. At the same time, the Chinese government is attempting an economic transformation that has never been attempted in such a short period of time. Looking forward, it is also important to put Chinese efforts in a broad context that includes the current slowdown in the global economy.

OPPORTUNITIES FOR U.S. BUSINESSES

Peter Hale, who currently serves as the senior advisor on China and other key trade matters to William Lash III, the Assistant Secretary of Commerce for Market Access and Compliance, stressed the opportunities for American firms created by China's membership in the WTO.

- *Working with American business and the Chinese government:* To help make sure potential benefits of China's WTO membership became real opportunities for U.S. businesses, the Department of Commerce has created a department-wide WTO monitoring team. Their China team is currently working with American businesses and the Chinese government to secure full compliance with WTO rules. This cooperative initiative includes training Chinese trade officials, holding seminars on standards setting, and helping strengthen the regime of intellectual property protection. To coordinate this work, officials from Commerce's Market Access and Compliance Division meet regularly with officials from the Chinese Ministry of Foreign Trade and Economic Cooperation.
- *Deliberate speed, not disputes:* Hale shared the view of the other panelists that there needs to be a concerted effort to settle the expected disagreements over how to interpret specific provisions of the bilateral trade agreement with China or the application of WTO rules. He did not expect any early resort to the formal WTO dispute settlement mechanism.
- *Chinese access to the American market:* Hale noted that the bilateral agreement with China provided some protection for import sensitive sectors of the American economy. For instance, limitations on most apparel imports are due to disappear in 2005 under the terms of the last or Uruguay Round of trade negotiations. China, however, agreed to limit its apparel exports for an additional three years. Hale also noted that the Department of Commerce (through its Import Administration) was monitoring certain sensitive sectors for any surges in Chinese imports.

NOTES

1. The question of potential instability has been raised by a number of China specialists. As an example, D'Amato mentioned Gordon Chang and his recent book, *The Coming Collapse of China*.

China Joins the WTO—Impact on Rural China

For over 50 years China’s agricultural sector has been heavily taxed to finance the country’s intensive industrialization program. Liberalization measures introduced in the 1980s significantly increased farmers’ autonomy and income. Still, low productivity and regional disparities persist owing to chronic under-investment and population pressure. As a result, ongoing agricultural reforms continue to face both economic and socio-environmental challenges:

- Technology and cost structures of agricultural production are internationally uncompetitive;
- The urban-rural divide also triggers massive migration into cities, causing significant demographic, infrastructure, and social strains throughout all of China’s regions; and,
- Exploitative production leads to accelerated resource depletion and ecological degradation.

Against this backdrop, China’s entry into the rule-based open trade regime embodied in the World Trade Organization arguably presents China’s farmers with their greatest challenge. Membership in the WTO would generally enhance the transparency of the Chinese regulatory structure and rule of law for the rural communities; yet exposure to international competition and enforcement of international standards involve substantial barriers and opportunities for China’s most vulnerable economic sector. Each of the two agriculture-related agreements in China’s accession package—the Agricultural Agreement and the Sanitary and Phytosanitary Agreement—poses specific challenges and opportunities for agricultural reform.

1. THE WTO AGRICULTURAL AGREEMENT

Key elements

- Tariff reduction from an average level of 22 to 17 percent and establishment of tariff rate quotas;

- Liberalization of trading rights for agricultural rights that give foreign firms direct access to Chinese customers; and,
- Commitment not to use export subsidies, and to cap and reduce certain domestic subsidies, with the exception of certain domestic agricultural support policies not directly related to trade (“green-box” policies).

Economic Impacts

- Increased access to foreign agricultural products and firms through reduction of tariff and non-tariff barriers and improved regulatory transparency; and,
- Challenges to China’s inefficient grain production sector; with more heavy impacts to the farmers and rural population in the less developed inland areas.

Socio-Environmental Impacts

- Possibilities of loss of market share and income deterioration for domestic farmers, especially those already lagging behind other economic players;
- Associated effects on rural migration patterns, regional inequalities, and social stability;
- Greater international dependence that might reverse the trend of predatory resource uses including inappropriate dependence on irrigation, use of marginal land, and high use of chemical fertilizers and pesticides; and,
- Greater incentive to switch to more value-added and environment-friendly crops and organic agriculture.

2. SANITARY AND PHYTOSANITARY AGREEMENT

SPS are measures taken to protect humans, animals, and plants from risks to life and health, including risks arising from additives, contaminants, or toxins in foods. Together with the Technical Barriers to Trade (TBT) Agreement it constitutes the backbone for the regulatory transparency of environmental and other technical standards of WTO members.

Key Elements

- Increased transparency and international monitoring of China’s technical, ecological, and health standards for animal and plant products; and,

- Removal of non-WTO-consistent SPS measures that have served as barriers to trade.

Economic Impacts

- Increased access to foreign animal and plant products through simplification of SPS procedures and standards; and,
- Increased access for the commercialization of international agricultural genetic research in China.

Socio-Environmental Impacts

- Challenges to technical and administrative capacities of Chinese SPS staff to ensure security of China's farmlands and pastures while complying with international rules on transparency and open trade; and,
- Greater exposure to genetically modified plant and animal products and varieties of which the farming community has insufficient knowledge or technical support.

This fact sheet was compiled by Sun Liang at the Wilson Center's Environmental Change and Security Project.

Appendix B

China's Entry into the World Economy 1949-2002

1949		The Peoples Republic of China is founded.
1958–1960		The Great Leap Forward
1966–1976		The Cultural Revolution
1972	February	Nixon visits China. The United States and China sign the Shanghai Communique in which both countries pledge to work toward normalizing diplomatic relations.
1974	December	Title IV of the 1974 Trade Act, also called the Jackson-Vanik Amendment, is passed conditioning MFN on a non-market economy's policy toward emigration.
1978	December	Beijing announces open-door economic reform policies.
1979	January	The US and China establish full diplomatic relations.
	July	The CCP makes plans for the creation of four Special Economic Zones (SEZ) along the Chinese coast: Shenzhen, Zhuhai, Shantou, and Xiamen.
	December	Agricultural reforms returning responsibility for land to individual farmers. This initiates the process of phasing out communes.
1980	March–April	China is admitted to the World Bank and the International Monetary Fund.
1981		Profit contracting system is established in state-owned enterprises encouraging greater productivity and growth.
1983	September	Regulations governing joint ventures are enacted in China.
1984		Fourteen coastal cities are opened to investment from other countries.
1986		China begins the process of applying for membership in the General Agreement on Tariffs and Trade (GATT).
	March	China becomes a member of the Asian Development Bank.

“It doesn’t matter whether the cat is black or white, as long as it catches mice.”
—Deng Xiaoping

1992	January	Deng tours the Shenzhea and Zhuhai SEZs and other cities in the South to support the open door policies. Pudong Development Zone is established in Shanghai. Beijing and Washington agree on trade measures to protect intellectual property rights in China.
	October	The Market Access Memorandum of Understanding with the U.S. called for the Chinese government to substantially reduce import barriers to facilitate two-way trade, especially in the product categories of great interest to U.S. firms.
1993		China reduces tariffs on over 3000 import items and abolishes import control for over 350 commodities.
1994		Fiscal reforms enacted to improve macroeconomic policy in China. Exports and imports grow by 97% and 66% respectively in 1994.
	June	The U.S. House of Representatives renews the extension of most favored nation (MFN) trading status for China despite concerns about human rights violations.
1997	July	The UK returns Hong Kong to China. The city becomes an autonomous Special Administrative Region of the PRC. Severe fluctuations in the Thai currency (bhat) touch off crisis in the Asian economies
1998		China's GNP rises to 7th largest in the world overall (nearly \$930 billion) and 2nd (behind the U.S.) in terms of purchasing power parity.
1999	November	U.S.-China agreement struck on the terms of Chinese admission into the WTO.
2000	September	U.S. Senate passes bill no. H.R. 4444 granting China Permanent Normal Trading Relations (PNTR) status and establishing the Congressional-Executive Commission (Levin Commission).
	October	U.S.-China Security Review Commission chartered by the National Defense Authorization Act chartered by H.R. 4205, the Floyd Spence National Defense Authorization Act.
2001		Tenth five-year plan continues to stress development of the rural interior provinces. Realized Growth for fiscal year: 7.3%.
	December	China admitted to the WTO on December 11. China receives permanent normal trade relations (PNTR) from the United States prior to entry into the WTO.
2002	January	Taiwan admitted to the WTO.
	(Fall)	The Chinese Communist Party convenes their 16 th National Congress

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