

NBR SPECIAL REPORT

China's WTO Accession: The Road to Implementation

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EXECUTIVE SUMMARY

China formally acceded to the World Trade Organization (WTO) on December 11, 2001, but fulfilling its many commitments to the organization will be a daunting task. What are the areas likely to pose compliance problems for China in the future and what are the steps that the United States and other member countries might use to ensure Beijing's WTO compliance? To address these issues, NBR has commissioned this special report.

Looming Impediments to Compliance

In the first essay, William B. Abnett, Senior Advisor at NBR and former Director for Chinese Affairs in the Office of the USTR, examines six potential obstacles:

1. Rule of law—the application and consistent enforcement of transparent laws (pp. 8–11)
2. Tariff-rate quotas (TRQs) in agriculture (pp. 11–12)
3. Genetically modified organisms (GMOs) or food products (pp. 12–14)
4. Courier and distribution services (pp. 14–15)
5. Trade-related aspects of intellectual property (TRIPS) issues (pp. 16–17)
6. Safeguard issues—the mechanisms that other nations can employ in order to protect themselves from “unfair” Chinese competition (pp. 17–18)

Role of Chinese Leadership

Mr. Abnett argues that Chinese leaders must make serious efforts in order to assure China's compliance with WTO commitments (pp. 20–21). They must:

- Overcome their lack of familiarity with the rule of law
- Educate their populace on the WTO's requirements for government and businesses
- Elucidate the degree to which they have implemented TRQs and their position on GMOs
- Liberalize courier and distribution services
- Comply with TRIPS issues
- Reduce the chances of other WTO members invoking the use of safeguard mechanisms

Significance of the Services Sector

In the second essay, Robert B. Cassidy, Managing Director of Trade and Investment at McKenna Long & Aldridge and former Assistant USTR for China, Taiwan, Hong Kong, and Mongolia, focuses on three areas of the services sector. These areas are important not only for China's implementation of WTO rules, but also for the future growth of the Chinese economy:

- Distribution (pp. 33–36)
- Financial services (pp. 36–38)
- Telecommunications (pp. 38–39)

Mr. Cassidy writes that liberalization and increased competition in each service sector render a multiplier effect that extends positive benefits to other sectors. Distribution determines whether products can get to markets, financial services allow producers and importers of goods access to capital, and telecommunications facilitate communication among, and integration of, markets.

Policy Recommendations

In order to accelerate Chinese and global economic growth and thus generate global growth commensurate with the economic and political size of China, Beijing should (pp. 40–44):

- Coordinate efforts of the various ministries responsible for trade in goods and services
- Implement legislation that would eliminate barriers to trade among provinces
- Apply the agreement to the service sector first, with the highest priority being assigned to the distribution and financial services
- Cooperate with other WTO members in order to hasten implementation

Mr. Cassidy feels that implementation will be a slow process and cites the China State Postal Bureau (SPB) as being a particular example of entrenched opposition to trade liberalization (p. 32). The U.S. government has also identified the SPB as a major impediment to implementation. Mr. Cassidy concludes that confrontations such as these are not necessarily bad because they serve to bring governments together, eventually resulting in agreements that form the basis on which a solid trading system depends, one based on commercial rules and laws.

CHINA AND COMPLIANCE WITH WORLD TRADE ORGANIZATION COMMITMENTS: THE FIRST SIX MONTHS

William B. Abnett

China is working very hard to implement its [WTO] commitments, but...acceding countries are normally required to have in place all necessary laws and regulations *before* accession [emphasis added]...The U.S. and other WTO members made an extraordinary exception for China when we agreed to drop this requirement because most simply realized it would take too long. Some were worried that the Chinese leaders who pushed for the WTO might have died by the time all measures at a central and local level were in place. That's why we negotiated transition periods for many of China's commitments as well as the so-called annual Transitional Review Mechanism in the WTO in Geneva.¹

...While China had made many changes to its trade regime over the fifteen years of the accession process, the complexity of the protocol and its annexes attest to the wide array of practices within China that remain non-WTO compliant at the time of accession as well as the concerns of existing WTO members on how well China's economic system would mesh in fact with underlying WTO obligations...²

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¹ Author's correspondence with an observer close to the scene, March 2002.

² Terence P. Stewart, *Accession of the People's Republic of China to the World Trade Organization: Baseline of Commitments, Initial Implementation, and Implications for US-PRC Trade Relations and US Security Interests*, April 30, 2002, Washington, DC: Law Offices of Stewart and Stewart, p. 16. (Referred to hereafter as the *Stewart and Stewart Report*). As of this writing, the report was available on the U.S.-China Security Review Commission (USCC) website <www.uscc.gov/access.pdf>.

Introduction

After 15 years of arduous and oftentimes confrontational negotiations, the People's Republic of China (PRC) formally became the 143rd member of the World Trade Organization (WTO) on December 11, 2001.³ Needless to say, China's trade regime has changed dramatically since the PRC first applied in July 1986 to resume its participation in the General Agreement on Tariffs and Trade (GATT). China has agreed to make changes that would not have appeared on its "radar screen" in the mid-1980s. The two opening quotations above refer to one of the most dramatic events in history: China's transition from a socialist command economy to a market-driven one that satisfies the general principles and rules of the WTO and lives up to the many commitments that China agreed to during its protracted accession process.

In order to gain membership to the WTO, the Chinese government has made more than 600 commitments, exclusive of "market access commitments contained in China's tariff and services schedules."⁴ These many commitments are described in hundreds of pages of official WTO documents.⁵ During a June 2002 Congressional Executive Commission on China (CECC) hearing, Susan Westin, an official in the Government Accounting Office (GAO), testified on the great number of China's WTO commitments, and the fact that China's very complex accession agreement runs over 800 pages, the largest in the history of the WTO.⁶ Given the overwhelming number of WTO commitments that Beijing has made and the brevity of actual Chinese membership in the organization, it is clearly beyond the scope of this short paper to monitor and evaluate China's

³ On November 10, 2001, the WTO's Ministerial Conference approved by consensus the text of the agreement for China's entry into the WTO. The WTO reported, "On 11 November, the Ministerial Conference at Doha approved the accession package of China. China's instrument of ratification was deposited on 12 November and it became a full member of the WTO on 11 December 2001." According to the rules governing accession to the WTO, China legally became a member 30 days after the WTO received notification that China's National People's Congress (NPC) had ratified the agreement. See the official WTO website for a press release <www.wto.org/english/news_e/pres01_e/pr252_e.htm>.

⁴ "Observations on China's Rule of Law Reforms," statement of Susan S. Westin, Managing Director, International Affairs and Trade, Testimony Before the Congressional Executive Commission on China (henceforth, CECC), June 6, 2002, p. 2 <www.cecc.gov/pages/hearings/060602/westin.pdf>.

⁵ The eighth revision of the "Report of the Working Party on China's WTO Accession" (197 pages) can be downloaded from The National Bureau of Asian Research (NBR) at <<http://lists.nbr.org/ChinaWTO/7-31-01DraftPOA-rev8.pdf>>; and the 67-page "Corrigendum," detailing changes and corrections to the revised eighth report, can be found at <<http://lists.nbr.org/ChinaWTO/7-31-01DraftPOA-rev8changes.pdf>>. The documents are also available in English on the WTO website at <www.wto.org/english/thewto_e/acc_e/protocols_acc_membership_e.htm#china>, and in Chinese ("officially" translated by the Chinese government) at: <www.moftec.gov.cn/moftec_cn/wto/wtolaw.html>.

⁶ Westin, Testimony Before the CECC <www.cecc.gov/pages/hearings/060602/westin.pdf>.

compliance to each of those 600 commitments.⁷ As noted above, many of these commitments (for example, in China's financial services sector) are phased in over a period of several years to help ease China's transition from a nonmarket economy to a market-driven one. Accordingly, this paper identifies areas that are likely to pose the greatest compliance controversies in the near future and the steps that the United States and other WTO member countries might use to ensure China's WTO compliance.

While it is unclear what tools Congress will use to measure China's WTO compliance, the U.S. Executive Branch has traditionally used a "squeaky wheel" test to determine which cases to pursue. Simply stated, "squeaky wheels" are best described as "quantitative estimates—usually based on U.S. industry assessments—of the impact of...foreign [trade] practices on the value of U.S. exports."⁸ The primary tool available to the White House is the Office of the U.S. Trade Representative (USTR), which consults on a regular basis with the private sector on trade policy issues. In general, the USTR's Office of Intergovernmental Affairs and Public Liaison administers the federal trade advisory committee system. The office also provides outreach to, and facilitates dialogue with, state and local governments, the business and agricultural communities, and labor, environmental, consumer, and other domestic groups. Established in 1974 and revised in three subsequent trade acts, this mechanism ensures that U.S. trade policy and trade negotiation objectives adequately reflect U.S. commercial and economic interests.⁹ In effect, the USTR's interface with the private sector provides the primary conduit for translating complaints raised by U.S. businesses into trade policy measures taken by the U.S. government. Under this institutionalized grievance process, the wheel that squeaks the loudest usually receives the most attention.

⁷ The U.S. and other WTO member governments have devoted considerable resources to monitoring and evaluating China's WTO compliance. See, for example, written testimony by William H. Lash III, Assistant Secretary of Commerce for Market Access and Compliance, to the USCC on January 18, 2002, <www.uscc.gov/teslas.htm>; and the future report (with a focus on bilateral commitments) that Congress imposed on the USTR in accordance with H.R. 4444 (the so-called PNTR Bill, which passed both houses of Congress and was signed into law on October 10, 2000, by President Bill Clinton). The statute is now titled Public Law No. 106-286.

⁸ See, for example, the foreword of *The 2002 National Trade Estimate Report on Foreign Trade Barriers*, as of this writing available online at <www.ustr.gov/reports/nte/2002/foreword.pdf>.

⁹ See, for example, the USTR's description of this advisory process <www.ustr.gov/outreach/index.shtml/>. The many links on that page lead to more detailed descriptions of the Executive Branch's "squeaky wheel" process.

Preliminary indications suggest that the following areas have already become the loudest of the “squeaky wheels” in monitoring China’s WTO compliance:

- rule of law issues
- tariff-rate quotas (TRQs) in agriculture
- genetically modified organisms (GMOs)
- courier and distribution services
- trade-related aspects of intellectual property (TRIPS) issues
- safeguard issues

The following sections detail the major points of contention in these areas and explore possible U.S. responses to them.

Rule of Law Issues

The rule of law issues, the first of the squeaky wheels, are also the single most likely source of future political conflict in China.¹⁰ This extremely sensitive area requires the interaction between China’s highly opaque political system and the western, rule-based obligations that Beijing voluntarily agreed to undertake when it joined the WTO. Christian Murck, Chairman of the American Chamber of Commerce (ACC) in Beijing, enumerated China’s six fundamental rule of law commitments under the WTO:

1. [To] [a]dminister in a uniform, impartial and reasonable manner all its laws, regulations and other measures of the central and local governments governing its trade and foreign investment regime
2. To conform central government laws, as well as all administrative and sub-national government regulations, rules, and measures to WTO obligations

¹⁰ For this report “rule of law issues” are those basic WTO principles (including intellectual property rights, consistent application of laws, regulations, practices, and transparency of laws) that require a WTO member’s trade laws to be generally stable and transparent, consistently and independently applied, and for that member to impose meaningful restraints on government officials and entities and other members of a ruling elite. This “rule of law” definition is taken from United States General Accounting Office, *World Trade Organization: Selected U.S. Company Views about China’s Membership* (September 2002), p. 7.

TRADE IN SERVICES IN CHINA: IMPLEMENTING THE WTO

Robert B. Cassidy

Charles Dickens would have relished writing about China's accession to the World Trade Organization (WTO): it was the best agreement and the worst agreement, a time of high drama and a time for farce, an era of euphoria and a time of despair. China's accession to the WTO was, and continues to be, a classic study in extremes: either the hope that China's accession will be a panacea for global economic woes or the fear that China will become the pariah of the trade world. Call them pundits, cognoscenti, the "China Hands," the free traders, or the trade fundamentalists. They are firmly ensconced at either end of the spectrum. Between these extremes lie the realists and the pragmatists who have observed the history of trade negotiations as replete with agreements initially described in glowing terms, but eventually decried because of the lack of implementation and enforcement.

China's WTO accession agreement was described in the most glowing of terms, in part because of the initially low expectations resulting from China's insistence throughout negotiations on acceding on political grounds, not on the standard, commercially-based terms. Yet the accolades were also based on substance. With the exception of government procurement and civil aircraft, China eventually negotiated with its WTO trading partners a comprehensive agreement covering all trade areas included in the Uruguay Round. The terms were fully compatible with, or better than, the terms of other acceding countries. Some provisions of the agreement were Uruguay Round "plus"¹ and other provisions were Uruguay Round "light."² Given its political, competitive, and global trading status, China acceded on equitable terms.

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¹ Provisions of China's accession to the WTO that would be considered as WTO "plus" include provisions dealing with pricing under antidumping and countervailing duty laws, with product specific safeguards, and with the transfer of technology as a condition for investment.

² Provisions of China's accession that would be considered WTO "light" include the ex-

While the accolades are well deserved, the fears are also real. Herein lies the paradox of trade negotiations: opening markets generates growth but trade agreements do not work. Applying the paradox to China, the WTO accession agreement will open markets for foreign suppliers of goods and services, generating greater economic growth in China and trade opportunities for foreign suppliers. China, however, will undoubtedly fail to implement all aspects of its accession agreement due to internal pressures, thereby generating disputes that will test bilateral and multilateral relations and confirming the conviction in the minds of many that trade agreements do not work.

The paradox arises because the process of opening markets involves two phases: first, the negotiations of the agreement and, second, the negotiations over its implementation. This second phase often takes longer to execute and is sometimes more difficult to achieve than the first phase. China is just beginning to implement its more significant commitments under the WTO. Most of the services commitments begin one year after accession, and only then will the problems start to emerge as China reviews, publishes, and implements the thousands of new regulations and decrees. Difficulties also will emerge over how those regulations actually are applied, a phenomenon not unique to China although likely to be more serious because of the lack of a Chinese judicial system based on the rule of law.

The paradox is not only a U.S. phenomenon; it also applies in China. The WTO accession agreement will open China and generate economic growth, but it will also bring in foreign competition at the expense of Chinese companies, demonstrating to some that the WTO agreement is not good for China. For China, the paradox arises from the fact that market opening measures generally involve winners and losers, raising pressures to help those losers in the implementation phase of the agreement, and thus feeding U.S. cynicism.

While it will be difficult, if not impossible, to circumvent the paradox, U.S. and Chinese policymakers can temper the negative reactions to China's WTO accession by avoiding the inevitable pressure to deal only with the squeaky wheels and by concentrating implementation efforts on those areas where the two extremes intersect the most, i.e., where implementation will have the greatest economic impact, both domestically and globally. The services sector stands out as an area that is crucial both to China's key trading partners and its own economy. Within the services sector, three areas have the greatest multiplier

tended phase-in periods for a country as competitive as China in sectors such as telecommunications, some of the chemical harmonization phase-in periods, and agreement by other WTO members to allow China to join the organization without enacting the legal provisions necessary for implementation.

effects: distribution, financial services, and telecommunications. This paper discusses why services are so critical to the WTO and to economic growth, how China opened its key services sectors, and what recommendations would reduce the likelihood that the trade paradox will apply to China.

Why Services?

Three reasons, among many, are compelling for why one should focus on services. First, services are a major U.S. export amounting to \$280 billion in 2001, and a trade surplus in services of \$69 billion with the rest of the world. Services account for more than one in every four dollars of total U.S. exports. According to World Bank data, services accounted for about 72 percent of U.S. gross domestic product (GDP) in 1998.³ Thus, negotiating market access for services was and is in the commercial self-interest of the United States.

Second, market access for many services translates into better market access for goods. Negotiations for trade in goods traditionally have concentrated on reducing and eliminating barriers at the border. Inside the border, however, the efficiency of services defines the ability of goods to penetrate the marketplace. Wholesaling, retailing, maintenance and repair, and transportation are services that affect the ability of goods to get to a market. In automotive trade, for example, getting automobiles to market quickly and efficiently requires a seamless web of services: transportation of the product to various markets, warehouse services, retail dealerships to view and test ride the vehicles; maintenance and repair to ensure product quality and to create the repeat consumer; financial services to finance inventories and auto sales; and an efficient telecommunications system. A number of studies demonstrate that increasing competition in services promotes a country's economic growth beyond the services sector, enhances a country's competitive position globally, and expands market access for goods.⁴

Third, opening the services sector to foreign competition improves the competitiveness of China's goods. While critics of China might question why the United States should care whether Chinese goods become more competitive, the trade pragmatists recognize that if the trade agreement does not work

³ World Bank, *World Bank Indicators 2000*, Washington, DC: World Bank, 2000, p. 188.

⁴ Alan V. Deardorff, "International Provision of Trade Services, Trade, and Fragmentation," *Review of International Economics*, vol. 9, no. 1 (February 2001) pp. 233–48.