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## China's Accession to the WTO: Economic Costs

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## China's Accession to the WTO: Economic Costs

### Abstract

In 2001, China achieved accession into the World Trade Organization (WTO) after more than ten years of politically charged negotiations. The unusually long negotiation period was an indicator of the controversy surrounding the issue, which remains heated to this day. Since China's accession, economists and politicians around the world have been watching to monitor the outcome after the five year phase-in period. While China's economic gains have been significant, and the increase in exports dramatic, China's accession to the WTO has had numerous negative effects. Some of these negative effects are the adverse impacts on the environment, the disparity in wages between rural and urban citizens, the displacement of neighboring countries' exports, and China's increased skill in utilizing the WTO's loopholes.

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# CHINA'S ACCESSION TO THE WTO: ECONOMIC COSTS

*Manh Dao, Cathy Geehan & Joshua Pandian*

In 2001, China achieved accession into the World Trade Organization (WTO) after more than ten years of politically charged negotiations. The unusually long negotiation period was an indicator of the controversy surrounding the issue, which remains heated to this day. Since China's accession, economists and politicians around the world have been watching to monitor the outcome after the five year phase-in period. While China's economic gains have been significant, and the increase in exports dramatic, China's accession to the WTO has had numerous negative effects. Some of these negative effects are the adverse impacts on the environment, the disparity in wages between rural and urban citizens, the displacement of neighboring countries' exports, and China's increased skill in utilizing the WTO's loopholes.

To best understand the implications, the WTO's history and Chinese involvement should be reviewed. The WTO came into being as a result of various negotiations. Serving primarily as a mediator for consultations between member nations regarding world trade procedures and disputes, the WTO stems from the Uruguay Round, which spanned from 1986 to 1994. These negotiations were done under the General Agreement on Tariffs and Trade (GATT) and became the successor of the GATT in 1995. The WTO is composed of 153 member states, with 30 serving as observers. The observers typically are states seeking permanent status. A common misconception about the WTO is that it expedites talks between countries and helps lower trade barriers to promote free trade. This is true; however it is not exclusively the work of the WTO. There are situations where certain barriers remain in place to avoid exploitations that could directly affect consumers, such as when some loopholes allow corporations to forgo certain environmental regulations. Essentially, the purpose of the WTO is to allow the free flow of trade internationally, so long as the undesirable effects are minimized. The WTO emphasizes transparency, enforceable agreements, reciprocity, safety valves and non-discrimination. Out of the

five, non-discrimination is arguably the most essential to the WTO. This can be seen in its Most Favored Nation policies, which are designed to ensure that no one nation is favored above another so that free trade can be more easily facilitated. It is what makes WTO such a broad organization.

The most notable thing that comes along with the magnificent increase in trade volume since 2001 is the deteriorating natural conditions for China. The pro-liberalization scholars have long reasoned that trade can be beneficial to the environment. One argument they make is that China could change its producing methods and technology to waste less resources and generate less pollution, and the government could raise the environmental standards. However, it is found that in China's case, the sheer increase in scale far outweighs other effects. In order to produce more and take advantages of the opening markets, production in China has expanded rapidly, which means the amount of resources and the amount of waste have also increased exponentially.

Under the WTO regime, the sectors of China's economy that have grown the most are the agriculture, aquaculture, textile, and industries. China's textile and apparel exports grew by more than 40 percent while its cotton consumption expanded by 34 percent over the first three years of joining the WTO, and is still growing at a significant speed; its growth in 2010 was 10%. This industry has one of the largest ecological footprints: it consumes a lot of water, and releases a lot of harmful chemicals as waste into the rivers and other water sources. In China, the technology, although improved, is still inferior to that of the developed nations: "water consumption per unit of production is about 50 per cent higher than in developed countries ... Dyes made in China usually have lower dye uptake and ... dye residual in wastewater is higher ... The sewer discharge per product is nearly double the amount discharged in developed countries." (Jahiel, 317)

Furthermore, a thorough modernizing program is nearly impossible – as Jahiel states that the small firms are the primary producers of textile, accounting for about 85% of all cotton textile manufacturers, and they have low access to financial sources and cutting-edge technology. The WTO helps worsen the situation in another way; the foreign direct investment (FDI) mostly flows to those small factories, because foreign investors simply want the profits these environment-harming factories can potentially make.

To cope with the fast growth in manufacturing, the raw resource industries are also augmented. China is already the world's largest producer and consumer of coal, the main resources used to produce electricity. And coal mining requires the demolition of mountains and land. "According to the 2005 China Environmental Report, about five billion tons of soil are washed away annually in the region, one third of which comes from Shanxi, Shaanxi and IMAR" (the poor north-western part of China) (Zhu, 14). Not to mention the toxic water discharge and the farmland occupied or destroyed by coal mining.

The rise in volume and variety of trade caused by the WTO creates yet another problem: the introduction of exotic, potentially invasive, species around the world. Ecologists have found many marine creatures in the ballast water of the ships (the water stored in the bottom of a ship to keep it balance) and many insects in the packing crates, accidentally carried from China to the U.S and vice versa. With the similar climates, those species can easily establish and cause ecological disasters. In 2000, it is calculated that it costs the U.S. around \$137 billion per year to deal with the invasive species, and for China, it is \$2.4 billion per year - only eight industries are calculated, which means the actual figure might be greater (Normile).

Statistics show inequality in China also increased at an alarming speed in the 2000s. The year 2009 marks the widest rural-urban income gap in China; the income ratio between the urban and rural population reached 3:33 to 1, and is predicted to keep rising (China Daily). During the high times of FDI inflows since China's WTO's accession, the urban areas and the industrial zones have attracted much attention, leaving the rural areas virtually untouched. While the impoverished people's net income is shown to increase,

it is nowhere near the amount earned by "the managers of State-owned enterprises, real estate developers and some private companies". (China Daily) Additionally, the percentage of rural enrollments in elite universities have shrunk from 50 percent in the 1950s to 17.6 percent in 2000, and it is widely agreed by experts that the figure might be as low as 1 percent in 2010 (Newsweek). These trends actually already happened before the WTO's membership; they are direct consequences of the rapid industrial growth, and especially the increase in FDI, as proved in Wan's article. It is not prudent to say that the WTO is the cause of these problems. However, it helps open up the market and encourages the investors to come to China, so the WTO has its indirect responsibility in worsening the inequality issue in China.

Not directly caused by the WTO's accession, the notoriety of Chinese products originated from a period of rapid export production. The Chinese government chose exports to be the focus of economic development after it joined the WTO. GDP growth was deemed more important than anything, and many quality controls are neglected. In 2008, evidence that melamine, a chemical usually used in making plastics, was found in a Chinese baby formula and shocked the entire world. It was further revealed that virtually all Chinese-produced dairy products, including ordinary milk, ice cream, and yogurt also contained melamine. The structure of the dairy-processing chain is one of the factors that contributed to the poisoning of more than 290,000 people, and 6 deaths. Modern factories, the ones who received the FDI, still get raw materials from small, poor, uneducated families who are desperate to make money. They can easily mix some melamine, which is very accessible and cheap, to increase the nitrogen content – the protein level of the milk. The Chinese government, only focusing on production, neglects its role of inspection and quality controls (Xiu, 467). Also, the news about lead in children's toys imported from China made consumers around the world fear the astonishingly cheap products again, which they bought, due to the help of the WTO. In the long term, China's product quality might be improved because the government wants to keep its reputation in the WTO, yet the problems are very pervasive and have roots in such basic stages that it will be very hard to fix them.

Due to China's geographical size, its abundance of highly elastic, low-cost labor supply, and the overall liberalization of trade due to its accession into the WTO, it is uniquely equipped to attract foreign investment. China's rapid growth has "triggered fears of increased competition for developing countries and hollowing out of manufacturing firms in advanced countries" (Greenaway, 153). First, developing countries that deal in similar exports, such as agricultural goods, textile products, and manufactured commodities, could see their export figures cannibalized by increased production of those goods in China. These countries are, for the most part, countries geographically close to China, such as Thailand and the Philippines. Because they are geographically close, their resources are similar, causing them to compete in similar sectors. Due to China's overwhelming influence in world trade, products from these smaller countries are often neglected for products of similar quality from China. It can be argued that, in the long run, importers would rather import from China because of China's stability and the opportunity for trade from China's other sectors. This would also open the door for future foreign direct investment in China from the importing nations. As a result, smaller neighboring countries can potentially be priced out of the market in the aforementioned sectors.

Similarly, developed countries fear that the shift of Chinese industries from the primary sector to manufacturing will take away from their own exports. More developed nations in the Asian region such as Japan and South Korea have already shifted resources into high tech manufacturing sectors in anticipation of China's growth, but China is starting to encroach on those sectors as well. With China's resources and manpower, this poses a significant threat for the economies of those developed nations (Greenaway, 153). Essentially, developed nations will suffer market share losses while developing nations would find their exponential growth curbed by China's influence. Though it is impossible to say whether or not China will continue to develop at the same rate, the progress it has made since its accession into the WTO and the access to new markets has given them the ability to economically cannibalize its neighbors. China's exports grow at an average of 19.7%, compared to 7.1% for other Asian countries with similar exports and 8.7% for the world's developing economies (Greenaway, 157).

Not only economically, China is taking steps into the legal side of international trade. It has become skilled in exploiting the nature of the WTO legal body, the Dispute Settlement Body (DSB), since its accession in 2001. China has had, to date, 23 cases brought up against it in the WTO, primarily stemming from the United States and the European Union (EU), although usually third parties will join in on the proceedings.

At the beginning, China was very naïve. The first case brought against China was in 2004; it was an accusation by the United States about the Value-Added Tax (VAT) on Integrated Circuits. China was accused of giving a partial refund to Chinese enterprises on integrated circuits, resulting in a lower VAT ("China – Value"). The case was fairly straightforward; China hastily removed the partial refund for enterprises in China. Third parties included the EU, Japan, and Mexico. China and the US reached an agreement without having to request the formation of a panel by the DSB. Yet, after its five-year phase-in period, China began to utilize the knowledge it had gained sitting in as a third party on various negotiations. In 2006 Canada, the US, and the EU brought an accusation against China concerning the imports of automobile parts because China was increasing the tariff on auto parts "from 10% to 25%, the same as the rate charge on imported foreign-made vehicles, if the parts comprise more than 60%" of the automobile (Zhang, 6). Instead of cooperating with the complainants, in this case China allowed proceedings to be carried out to their full term, and due to a lack of retrospective compensation, China did not have to compensate for "any damages made during the litigation process at the WTO, which can easily take two years" (Zhang, 14). Following the panel ruling, China even went so far as to appeal the decision, causing another two months of discussion and prolonging their practices ("China – Measures Affecting Imports"). Similar tactics were taken by China in cases such as the case for intellectual property rights in China and the case regarding procedures that affect trading rights and distribution services for products of an audiovisual nature ("China – Audiovisual Entertainment Products," "China – Intellectual Property Rights").

The most recent case brought up against China involves electronic payment services. Foreign suppliers are forced to go through a Chinese entity for electronic payment services, which

causes those suppliers to use the undervalued Yuan instead of their domestic currency ("China – Certain"). There are also inconsistencies regarding payment methods for other members of the WTO because access is guaranteed to all merchants that use the Chinese entity, while others are forced to negotiate for access. The main complainant is the United States, with third parties including Australia, Ecuador, the EU, Guatemala, Japan, and the Republic of Korea. It is important to note that of the third parties involved, five of them are major players in world trade, indicating that this issue holds serious weight for a large portion of the economic world. This issue has yet to be fully resolved, yet the request for consultations was made on September 15, 2010, with a panel yet to be formed ("China – Certain"). Due to the procedures of the WTO and the complexity of the case, it is doubtful that it will be resolved in the near future. In fact, it is most likely that it will be drawn out like previous cases, which could have a severe impact on the world economy. This is just one example from the recent history of cases brought up against China that have yet to be explored or even discussed. In the meantime, China remains free to continue its practices unregulated. It should be noted that if China had not joined the WTO, other countries would have been able to legitimately punish China with tariffs and other trade barriers, forcing China to follow the general rules of the market. Its WTO membership definitely provides an edge for its legal maneuvering.

Not only has China learned how to use the WTO system to its advantage, there is ample data from the 1990s that shows they have been growing significantly without the WTO, and by joining the WTO China now faces more red tape, as do its trading partners (Greenaway 152). While this is not a point often thought about, it is something worth considering when taking into accounts the risks and benefits of China in the WTO.

It is difficult to discern whether the negative changes brought by and upon China would have still occurred had it not joined the WTO, but certain elements of the WTO have a clear correlation with effects in the world. Due to its accession, China was able to shift towards a more industrial style of economy, which has had a distinct effect on the environment of China, particularly in the water supply. While wage disparity could have occurred regardless of whether or not China joined the WTO, the influx of manufacturing work

surely influenced the widening gap between the urban and rural communities. Other Asian countries have experienced a decrease in exports due to China's rapidly expanding export sector. Before China joined the WTO, the various agreements it had with other nations would be enforced on that nation's terms. Now given that China is a part of the WTO, other nations are forced to work through the laws of the system, a system that China is very adept at manipulating. Overall, while there are numerous positive effects of China's accession, the risks outweigh the benefits in this case.

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