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China's Accession to the WTO: Economic Benefits

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Abstract

2001 was a landmark year for China, who finally gained accession to the World Trade Organization (WTO, 2011) after 15 years of negotiations. China's accession to the WTO has helped both the Chinese and the world economy. China's accession resulted in astounding growth of exports, and a reduction in tariffs both on imports into China and tariffs placed on Chinese products. A burgeoning export market and looser investment restrictions led to growth in Chinese capital. The accession requirements placed upon China brought the nation into a period of greater trade liberalization, weakened state-run enterprises, and giving more power to private interests. The WTO accession agreements also caused China to make international trade law more transparent and even. Other nations have benefited from more access to Chinese markets and vice versa.

CHINA'S ACCESSION TO THE WTO: ECONOMIC BENEFITS

Graham Boden

2001 was a landmark year for China, who finally gained accession to the World Trade Organization (WTO, 2011) after 15 years of negotiations. The WTO is a multilateral trade organization whose purpose is to help trade flow freely while preventing negative side effects, as well as to serve as a place for settling international trade disputes and negotiations through unbiased legal procedures. The WTO was formed from the General Agreement on Tariffs and Trade (GATT), which was signed by 23 nations in 1947 (Fung, 2006). One of the original contracting nations was China. One of the GATT's main topics was the most-favored-nation (MFN) clause, which gave fellow contracting nations the exact same treatment as other contracting nations, meaning no single country could gain an advantage through lighter customs rates or lower tariffs. One fault of the GATT, however, was that it lacked any mechanism for enforcing cooperation or negotiation. In 1949, only 2 years after signing the GATT, the Chinese nationalist government located in Taiwan withdrew China's membership from the GATT (Fung, 2006). 30 years later in 1979, however, China entered a period of trade liberalization, though the Open Door Policy (Bhatt, 2004). In 1986, China submitted an application to the GATT to resume their status as a contracting party, and negotiations started (Fung, 2006). In 1995, the GATT changed its policies and renamed itself the WTO (Bhatt, 2004). Upon formation of the WTO, China requested the conversion of its status as Working Party to Full Membership. In 2001, after 15 years in total of ongoing negotiations, China was unanimously voted into the WTO (Fung, 2006). Today the WTO consists of 153 member nations and is one of the largest trade organizations in the world.

China's accession to the WTO has helped both the Chinese and the world economy. China's accession resulted in astounding growth of exports, and a reduction in tariffs both on imports into China and tariffs placed on Chinese products. A burgeoning export market and looser investment restrictions led to growth in Chinese capital. The accession requirements placed upon China brought the nation into a period of greater trade liberalization, weakened state-run enterprises, and giving more power to private interests. The WTO accession agreements also caused China to make international trade law more transparent and even. Other nations have benefited from more access to Chinese markets and vice versa.

WTO accession has led to an increase in Chinese exports, resulting in greater economic growth. Accession to the WTO gave China better market access to its 152 WTO trade partners (Bhatt, 2004). The MFN clause of the WTO agreements helps prevent discrimination against Chinese exports in other WTO nations (WTO, 2011). Greater foreign market access created a surge in the export of Chinese products. From 2002 to 2007, net exports as a share of GDP in China increased from 2.6% to 7.7% (Chen, 2009). By 2010, China's current account balance was $305 billion (Google public data, IMF). China's exports have primarily been labor-intensive manufactured goods due to China's abundance of inexpensive labor (Chen, 2009). This focus on labor-intensive manufacturing shifted workers away from the primary sector towards the secondary sector (Marti, 2011). The percentage of workers employed in agriculture decreased from 50% in 2001 to 11.2% in 2010 (World Bank, 2011). Furthermore, the percent of GDP that is attributed to the primary sector decreased from 23.5% in 1994 to 11.7% in 2006 (Marti, 2011). As more labor-intensive products are manufactured, there is a greater demand for labor to continue production. This higher demand resulted in rising real wages in China across industries. From 2001 to 2006 real annual wages across industries doubled from 12,000 yuan on average to 24,000 yuan, in terms of 2007 yuan (Yang, 2010). This increase in real wages was not limited to the Chinese upper class. It included typically low-wage industries such as manufacturing and retail. China's export market also greatly benefited from increased foreign direct investment (FDI) inflows due to accession. In the early 1990s, FDI inflows

into China were large, but stagnated by the end of the decade. This stagnation was attributed to restrictions on FDI, government corruption, and inefficient state-owned enterprises (Chen, 2009). Accession to the WTO, however, reduced restrictions on FDI in China, resulting in a new surge in FDI inflows to China. From 2001 to 2002 alone FDI inflows increase 30% (Fung, 2006). The growth of FDI has been shown to help accelerate export growth (Chen, 2009 Zeng, 2010). Foreign-invested firms (FIFs) are some of the largest exporters in China, with their processed exports totaling 45% of Chinese exports. FDI also helps stimulate employment. Between 2001 and 2006 FIFs provided an additional 11 million jobs in China (Chen, 2009). The greater access of foreign markets for Chinese exports as well as the increased FDI inflows brought by WTO accession has greatly benefited the Chinese economy.

Tariff reduction policies required for WTO accession were introduced to China to benefit both foreign and domestic enterprises. As stated above, the MFN status of the WTO helps China's export industries (Bhatt, 2004). MFN status allows China to face the same trade barriers as competitors, allowing China to compete with other nations fairly. These measures are not entirely sudden. Discriminatory measures taken by other nations against China were phased out as specified in Annex 7 of the Protocol (roughly five years since accession for most measures) (Cheong, 2003). These phasing-out periods allowed time for foreign markets to adjust to trade without a sudden flood of cheap Chinese exports. Furthermore, reduction of China's domestic tariffs reduced efficiency loss brought about by the misallocation of resources. Reductions in tariffs also lowered prices for consumers while helping foreign producers by reducing costs and providing greater market access. In addition to removing tariffs, China agreed to limit the non-tariff measures they utilize only to those listed in Annex 3 of the Protocol, many of which have a scheduled date to end (Cheong, 2003). China also agreed to remove performance, trade balancing, foreign exchange balancing, and prior experience requirements, in order to grant permissions to invest, import licenses, quotas and tariff rates regardless of existing domestic demand (Cheong, 2003). China's accession agreements allowed for the continued use of some forms of trade barriers, but these barriers were temporary measures to slowly introduce Chinese trade to the world economy. China has agreed not only to remove tariffs, but is also now responsible for preventing the formation of non-tariff barriers to trade regardless of foreign competition.

The growth of the Chinese export economy and FDI inflows resulted in the growth of domestic Chinese capital. Since accession to the WTO, average capital stock growth rates have risen, a change from the decreasing growth rates of 1998-2001 (Chen, 2009). The increase in FDI since accession also helped the development of capital by acting as a vehicle for technology transfer. Regions that receive FDI benefited from the advanced foreign technology which is brought in from investing firms. Some of the largest attractors of FDI are capital-intensive projects (Fung, 2006). Thus, the investment brought into China is used for the development of capital. Furthermore, FIFs shifted China toward the production of high-tech goods (Chen, 2009). Since accession China has gained productive capability in IT products (Fung, 2006). China's export of high-tech products rose greatly, with 80% of FIF exports in 2004 consisting of high-tech goods (Chen, 2009). Between 2000 and 2005 China's total exports of high-tech products increased from 17% to 32% (Chen, 2009). While it might seem to be contradictory that China exports capital-intensive goods considering that it was established above that China is labor-abundant, in this case China is exporting both labor-intensive manufactured goods as well as high-tech products. The FDI investments are therefore causing technology transfer and capital growth. It might seem worrisome that if FDI inflows are so large that China would encounter the same problems as found in maquiladoras in Mexico. Maquiladoras are factories in Mexico wholly owned by foreign corporations who utilize the cheap local labor to produce items to be imported back to the firm's home country. Maquiladoras are well-known for their underpaid, overworked employees. China avoids this problem due to the gradual decrease in FDI limitations. Initially after accession, foreign investors could not control more than 49% of a firm, but restrictions on foreign ownership were reduced years after accession (Bhatt, 2004). By slowly allowing more foreign investment over time, control of fixed capital is predominantly Chinese, with 95% of fixed capital in China owned by domestic sources (Chen, 2009). China's accession into the WTO helped the development of capital within China through the flow of technology and

the development of production methods.

The WTO accession requirements provided an impetus for the Chinese economy to enter a period of liberalization. In order to qualify for WTO accession, China has been forced to greatly weaken its state-run enterprises (SOEs) and allow for greater private competition (Cheong, 2003). State-run enterprises are now required to make business decisions based solely on commercial considerations (Cheong, 2003). SOEs must act as any business would because decision-making cannot be changed by the political leanings of the Chinese government. The WTO accession allowed for non-state enterprises to own a portion of trading rights in agriculture (Fung, 2006). This weakened the grip that SOEs have over Chinese agriculture, and brought more power to private agricultural trade. Loosening of government control of the economy promoted greater efficiency and quality due to increased competition. For example, a liberalized logistics sector (transport, warehousing, material handling, packaging) led to better infrastructure and lower transportation costs (Bhatt, 2004). Lastly, the push for liberalization resulted in the 2001 Trade Union Law, which allowed for collective negotiation (Fung, 2006). This law has helped Chinese workers by allowing for the formation of labor unions, granting employees more power to negotiate wages and working conditions. The push for liberalization brought on by China's accession to the WTO has resulted in a shift of economic power away from SOEs and toward private interests.

As a part of the reform required by WTO accession, China is responsible for increasing transparency of trade information and law. Increasing transparency requires not only more effective promulgation of existing trade law, but also making the inner workings of legislative processes more apparent to firms. Transparency is useful for both foreign and domestic firms as it allows them to make more informed decisions based on government trade law. China succeeded in increasing the publicity of existing trade laws. The WTO TBT-SPS website has been set up and contains information concerning China's technical barriers to trade (Chen, 2009). Furthermore, the Chinese government regularly publishes manuals on Chinese foreign trade, which include the printing of laws which may be of interest to both domestic and foreign firms (Cheong, 2003). On the legal side, the Chinese government has been moving toward reform aimed at increasing the balance of Chinese law. For example, the 2004 Administrative Licensing Law established the publicity of all administrative licenses. In addition, the 2008 Opinions Concerning Deepening Reform of Administrative Management Mechanisms called for administration modes to be transparent and standardized (Chen, 2009). Through the Chinese accession, the Chinese government has been on the path toward greater transparency and balance.

China was not the only nation to benefit from WTO accession. As stated above, the MFN status granted to WTO members allows all countries to trade on an even playing field. This status had beneficial effects not only on China's exports abroad, but also on other WTO members' exports to China. China's imports now all face the same tariffs and barriers to trade, thus making each country's trade with China representative of its comparative advantages, not its political power. Increased trade with China also benefited its fellow developing Asian economies. Since China focuses on labor-intensive manufacturing, it is a large market for raw materials that come from the other developing Asian economies (Chen, 2009). Asia's newly industrialized economies account for 24.59% of all of China's imports in 2007 (Chen, 2009). In 2003 18% of South Korean Exports and 12% of Japanese exports were sold in China (Fung, 2006). China even has a rising trade deficit with other Asian economies (Chen, 2009). China's role as a market for exports contributed to the growth of its developing neighbors, just as the US and EU's role as markets for exports contributed to the growth of the Chinese economy (Chen, 2009). Furthermore, the reduction in barriers to Chinese imports resulted in lower prices, which benefited the US consumers who purchase the lower-priced imports (Fung, 2006). China's accession to the WTO has brought benefits to both developing neighbors as well as its more developed trade partners.

Despite the benefits of China's accession to the WTO, there have been concerns regarding possible negative side effects of its accession. As the influx of FDI has increased the growth of capital and exports, there has been concern that the firms that received FDI have an advantage over domestic firms. Although firms which received large amounts of FDI had a productive advantage

shortly after the accession, the difference in the labor productivity of domestic and FIFs has decreased. In 2001 the labor productivity of FIFs across industries was 1.6 times that of domestically invested firms. However, by 2006 FIFs were only 1.02 times more productive (Chen, 2009). The decrease in labor productivity shows that although FIFs once had an advantage, FIFs are no longer more productive than domestically invested firms.

As the Chinese economy booms, foreign governments have been worried about the undervaluation of the yuan. While the yuan is currently undervalued, sudden revaluation may harm China's growth. Sudden revaluation is expected to greatly reduce the number of China's exports, resulting in massive unemployment, specifically in the textiles, clothing, shoemaking, toys, motorcycles, and agricultural sectors. A sudden appreciation of 5-10% is estimated to cause a loss of 3.5 million non-agricultural jobs in China (Chen, 2009). However, if revaluation occurs slowly then there should be less intense negative repercussions. In fact, the yuan appreciated 18% from January 2006 to June 2008 (Chen, 2009). Immediate revaluation is dangerous to the Chinese economy, so China is cautiously appreciating the yuan to meet international concerns while still avoiding the possible dangers to its export markets.

Although the Chinese economy has seen growth in industrial exports, Chinese farmers face considerable competition with agricultural imports from the US. Chinese farmers face competition with agricultural imports from the US, but this competition is only in grains and oilseed-based products (Fung, 2006). China actually has a comparative advantage in rice, meats and horticulture (Bhatt, 2004). The damage to China's agriculture was further limited by the trade-rate-quotas (TRQs) that have been temporarily allowed to be maintained after accession. China was allowed trade-rate quotas on wheat, rice, corn, cotton, soybean products, palm oil and rapeseed oil. Since 2001, these quota levels decreased as China's economy slowly reacted to agricultural competition (Fung, 2006). The approved TRQs that China maintained allowed Chinese agriculture to slowly adjust to increased foreign competition. TRQs restricted structural unemployment in the agricultural sector and the limited protection allowed Chinese grain producers to maintain some measure of competitiveness in the face of overwhelming foreign competition (Chen, 2009).

The growth of cheap Chinese exports has undercut the domestic industries of its trading partners. Although increased trade competition with China would negatively impact the domestic businesses of its trade partners, a number of the trade complaints against China come from nations who lack comparative advantages in manufactured goods. For example, when US antidumping action was taken against Chinese furniture imports in 2003, imports of furniture to the US from Indonesia, Brazil, Thailand, and Malaysia increased dramatically. The reason for the surge in antidumping action taken against China, as well as the concern for China's trade partners, is not entirely due to foreign competition issues, but from domestic competition issues. Firms that invest and build business connections in China gain a supply advantage over the firms that choose to pursue imports from other sources. The domestic firms who do not import from China are ultimately negatively impacted as they cannot compete with their fellow importers' cheaper goods. The firms that do invest in China, however, benefit as these firms gain income from their investments into China as the Chinese export market grows, and the business connections built by investing firms can help create an advantage for investing firms (Zeng, 2010).

Although China's accession has caused some negative side effects, the consequences are limited. The difference between FIFs and domestic firms has decreased, and although the yuan is currently undervalued, slow appreciation is preventing damage to Chinese export markets. Although accession has caused some harm to Chinese agriculture, the harm is only limited to grains and oilseeds. Instead, China's use of TRQs allowed a 'soft landing' for Chinese agriculture. The increased disputes with China's trade partners is not necessarily a result of increased competition from China, it also represents changing domestic competition among importers.

China's accession to the WTO in 2001 brought a number of benefits to both China as well as the world. Reduced barriers to trade and larger FDI inflows boosted Chinese export markets. Accession resulted in the reduction of tariffs and barriers to free trade. The booming export economy and FDI inflows improved the growth of capital in China, resulting in a shift toward higher

technology. The accession requirements lessened the power of Chinese SOEs, and gave more power to private interests within China. The transparency requirements of the WTO accession resulted in greater trade law publication and regulations. China's trade partners also benefited. Other WTO members utilized their MFN status to face equal trade barriers, and neighboring countries gained a large market for raw material exports in China. 2001 was truly a landmark year for China.

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