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## China – Normal Trade Status Partnership

### Introduction:

There are those who argue that the United States should economically punish other countries, such as China, that do not adhere to policies which favor our own best interests – either economically, politically or socially -- or which do not uphold the same level of human rights which we advocate. As an example, Tom DeWeese (2006), writing in Enter Stage Right, declared that “China attacked our intelligence gathering plane, almost killing the U.S. airmen and women on board. They held our military personnel hostage. They have stolen our most sensitive technology. China violently oppresses its citizens. It uses our trade dollars to expand their military power. They imprison, torture and kill those who advocate freedom in their own nation as well as religious adherents. They hate Western civilization in general and America in particular. In all likelihood, Chinese nuclear missiles are pointed at America. They help to flood the United States with illegal drugs. Throwing money at China is a fool's game.... and the price we will pay for failing to draw a line in the sand will be increased.”<sup>1</sup>

Conversely, some may argue that the best method of persuading other countries both to improve their fair trade practices with the United States, as well as to eliminate practices which may be deemed abusive of their citizens, is through even greater economic cooperation, thereby having the simultaneous effect of increasing opportunities for American businesses, and opening avenues for discussion regarding human rights issues.

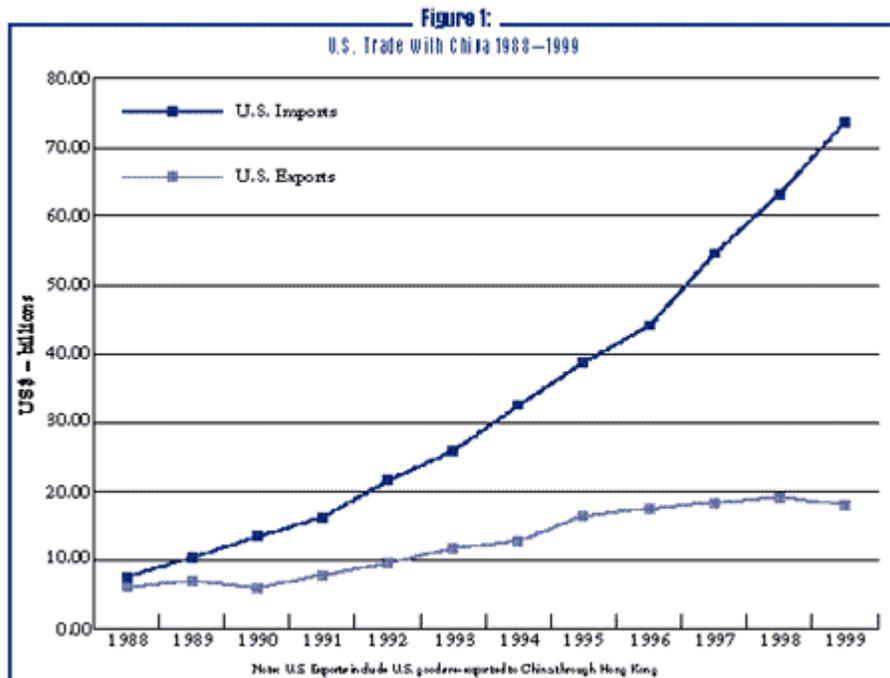
This memo presents information about who is helped and who is hindered by China's normal trade status with the United States.

### Background:

In 2001, China became a member of the World Trade Organization (WTO). The cornerstone principle of the World Trade Organization is that members provide each other unconditional Most Favored Nation trade status, now called Permanent Normal Trade Relations (PNTR) in U.S. trade law.<sup>2</sup> Our exports to China have grown dramatically since China's entry into the World Trade Organization (WTO). China was our eleventh-largest export market the year before WTO entry. In 2004, it became our fourth-largest export market. By mid-2005, China and Hong Kong together trailed only Canada and Mexico, our two free trade area partners and neighbors, as a market for US products.<sup>3</sup>

Analysis:

Were China's PNTR status revoked, it would mean that U.S. companies would not benefit from the most important commitments China has made to its WTO membership. Gaining the full range of benefits is particularly important in light of the large and growing deficit the United States faces in its trade with China, as shown in the following chart.<sup>4</sup>



Maintaining China's PNTR status provides U.S. companies the same advantages that accrue to companies from Europe, Japan, and all other WTO member states. It also provides an important boost to China's leadership, who are taking significant economic and political risks in order to meet the demands of the international community for substantial additional economic reforms as a condition for its WTO membership.

The following have been some of the positive aspects of extending PNTR to China<sup>5</sup>:

- China's agricultural tariffs fell to an average of 17.5% during 2004, from over 30% prior to its entry into the WTO. Similarly, China liberalized imports of major agricultural commodities, import and distribution rights granted to foreigners.
- China's average tariff on industrial products fell to 9.4% by 2005; including elimination of all tariffs on high-technology products; auto tariffs fell from 80-100% to 25% by 2006.
- Import and distribution rights to foreign corporations were granted, allowing them to set up wholly-owned distribution, sales (including retail), shipping, and service networks.
- China allowed the establishment of foreign financial services - banking, insurance, and securities - full market access in all activities and regions, and national treatment for foreign banks; along with minority ownership in domestic securities firms and most insurance businesses.
- China ended the ban on foreign investment in telecommunications, allowing up to 50% ownership in value added (internet) and paging services; 49% ownership in mobile telecom, domestic and international services.
- Further, China increased market access for professional services, including accounting, consulting, engineering, medical, and information technology.

- The WTO agreements commit China to implementing and enforcing international standards on protection of intellectual property, providing for increased access and distribution rights for motion pictures, music, and software.

Another advantage for the United States is in the area of imports from China. The surge in United States imports of Chinese products over the past few years can be largely explained by two factors. First, China's production of low-cost, highly labor-intensive products has grown greatly in recent years. A main reason for this is that the cost of goods is at a lower level for the Chinese than for almost any other producer. In addition, the United States' demand for products of this type has and mostly likely will continue to rise in the future. In response, Taiwan and Hong Kong have moved many of their production firms into China to take advantage of lower labor costs. This is good for the economy of China and it also helps to supply the United States with low cost goods.

A number of unique safeguards and protections were imposed as conditions to China's membership in the World Trade Organization, such as<sup>2</sup>:

1. Allows the United States to continue to treat China as a non-market economy in anti-dumping cases for 15 years after accession; this methodology generally results in the application of larger anti-dumping margins against Chinese imports.
2. Permits the United States to implement a product-specific safeguard to prevent large import surges from China. This safeguard, which allows the United States to impose restrictions on imports from China more easily than imports from other WTO members, and will remain in effect through 2013.
3. Allows the continuation of a safeguard mechanism to prevent textile import surges until the end of 2008; China will be the only WTO member subject to this mechanism.

On the other end of the spectrum, the combination of economic reforms China has undertaken have created difficulties for their domestic workforce. As Mr. Lardy (2006) points out in his paper<sup>2</sup>, the measures have increased foreign competition, thus placing significant additional pressure on China's domestic firms to lower their costs and prices. He contends that millions of urban workers have lost their jobs in state and collective factories as China accelerates domestic economic restructuring. "Many of those who have been laid-off," says Mr. Lardy, "have found new jobs in the competitive portions of the economy—the rapidly growing private, foreign-funded, and export-oriented sectors. But those who lack the skills, or live in cities long dominated by state-owned factories, have little prospect for finding new jobs locally. Rising levels of urban unemployment, compounded by delays in the distribution of living allowances due laid-off workers and pensions due those already retired from failing state-owned companies, have led to widespread urban violence. In rural areas, too, the prospect is for substantial dislocation as China reduces its subsidies for basic staple commodities, such as wheat and corn, again in anticipation of increased inflows of lower-priced foreign products."

The willingness of China's leadership to incur these substantial short-term economic and political costs in the pursuit of long-term economic gains is a measure of the depth of their commitment to further reforms.

#### Conclusion:

From the information given in this memo, the groups which may, in the short term, suffer the greatest economic hardships would be that portion of China's unskilled labor force currently employed in collective industries during its transition from a fully-planned to a more liberal open market economy; whereas, maintaining PNTR with China is strongly in the interests of the West, since U.S., European, Japanese and Australian firms would

benefit from the market opening measures to which China agreed. They would be eligible to participate in a number of the liberalizations, particularly in the service sectors that China is required to open more fully. As well, continuing PNTR to China would strengthen the position of reformers in China, who have overcome intense domestic opposition to membership in the World Trade Organization, which may lead to their further cooperation in other areas of international concern, such as in human rights matters.

## References

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