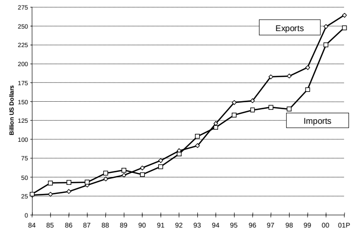
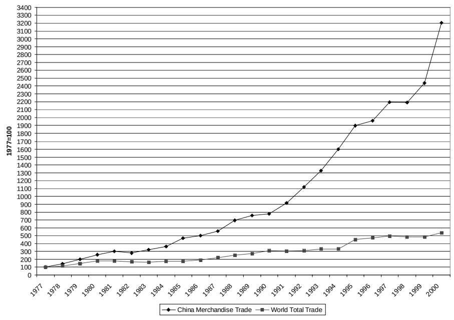
Foreign Trade and WTO

- In 26 years, from one of the most isolated economies in the world to an integrated part of the global economy
- By 2005, China is the third largest in foreign trade after the U.S. and Germany
- Major features
  - Both export and import grew fast
  - Trade and FDI are inter-related
- Export to GDP ratio
  - 1978: < 5%
  - now: > 30%
- Caution: Export is gross value, not value added
  - If value added is 30% of gross value, then true contribution of export to GDP is perhaps 10%

Trend of China's Foreign Trade



Growth of China Trade vs. World Trade



Trade Regimes

- Two way relationship between domestic reform and opening up
  - Domestic reform helps foreign trade and investment
  - Foreign trade and investment push for more reform
- Trade regimes
  - Pre-Reform: central planning
  - Post-reform and pre-WTO: dual trade regime
  - Post-WTO: uniform, international standard

The Pre-Reform Trading Patterns

- 1950s
  - Major trading partners were other centrally planned economies
  - 1/2 of foreign trade was with the Soviet Union
  - Trading pattern: import machinery, export food and textile products
- 1960s and 1970s
  - Became isolated from both capitalist and socialist worlds
  - "Self-reliance" development strategy
  - But major trading partners were Western countries of Europe and Japan in the 1970s
  - Trading pattern: import grain and machinery (fertilizer plants and steel mills), export textiles and light industrial goods

The Pre-Reform Trade Regime

- Foreign trade regime is part of central planning
- 12 foreign trade companies, monopoly in each market (e.g., grain, machinery, textiles)
- Foreign exchanges strictly controlled, serve the purpose of trade plan
- Import
  - Ease severe domestic shortages (food, materials)
  - Overcome bottlenecks in domestic production (capital equipment)
- Export
  - For the purpose of earning hard currency to finance import

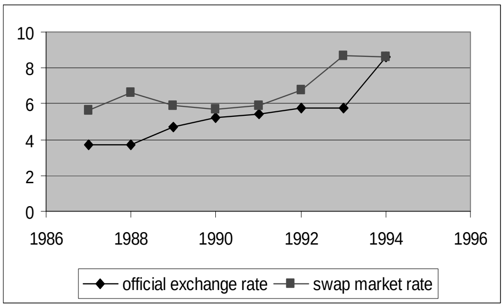
Dual Track in Foreign Exchange Market

- Devaluation of currency: from US$ 1=1.4 yuan to US$ 1 = 8.7 yuan in 1994, to US$ 1 = 8.27 yuan in 2003, before appreciated to US$ 1 = 7.73 yuan in 2007
- 1986-93: Dual track foreign exchange regime
  - Official exchange rate (Foreign Exchange Certificate, FECs)
  - "Swap market" rate at Foreign Exchange Adjustment Centers
- Exporters were allowed to keep a proportion of foreign exchanges and use the swap market
  - Provide incentives for exporters
  - More efficient allocation of foreign exchange

Dual Track in Foreign Exchange Market

- 1994: The two rates were unified at the swap market rate
- 1996: current account convertibility
  - Meaning: any authorized importer of goods and services can purchase foreign exchange upon presentation of proofs
- China's official foreign reserve
  - Over US$ 1 trillion by the end of 2006
  - More than 1 year's import value

Dual Foreign Exchange Rates



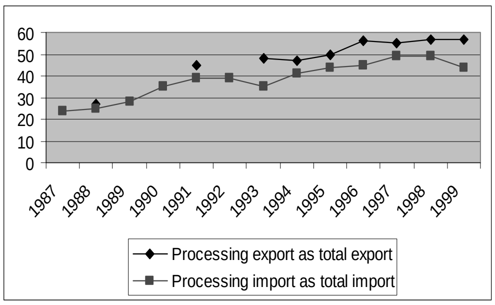
The Dual Track in Foreign Trade

- Two sectors
  - One sector, the old sector, mainly import substitution ("ordinary trade")
  - Another sector, the new sector, mainly export oriented ("processing trade")
- Advantage of the dual track
  - A free market is introduced without disrupting effects on the existing old sector
  - The old sector is not hurt, the new sector benefits

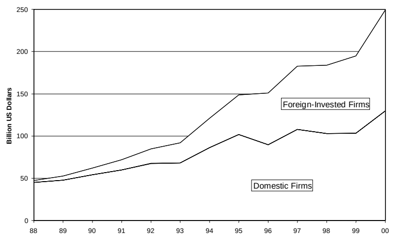
The Dual Track in Foreign Trade

- The export oriented sector (processing trade)
  - Many foreign invested firms
  - Many located in Special Economic Zones, but not all
  - Duty free: imports for export processing purposes are duty free
  - Tax benefits: corporate income tax holidays for three years
  - Minimum administrative interference: market oriented
  - Have to commit to export
- Examples in other countries: export processing zone in Mauritius, an island in Indian Ocean

Processing Trade



Who Are the Exporters



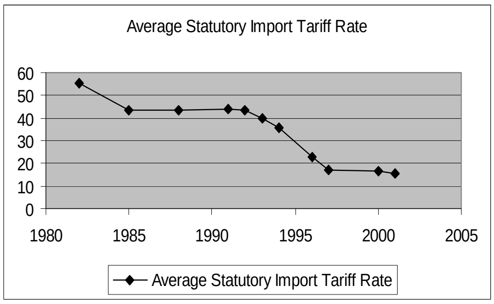
Demonopolization of Foreign Trade

- Increased the number of foreign trade companies (FTC) from 12 to over 5,000, some are national, some are local
- Each FTC has "business scope"
- Over 10,000 state enterprises granted direct export and import rights
- Foreign trade companies procure from more efficient firms
- Devaluation and VAT rebates good for export
- But FTC insulates exporters (enterprises) from the world market

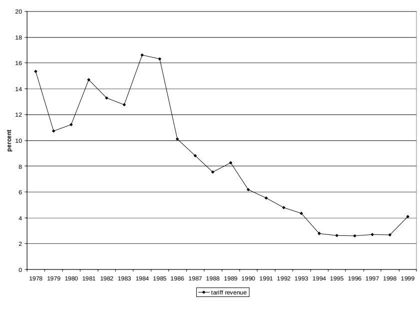
Import Side

- Tariffs: declining but still high in 1990s (from over 40% to close to 20%)
- Non-tariff barriers (NTBs): quantity control remains (such as licensing)
- But effective tariff rate is much lower than nominal tariff rate
  - Many exemptions
  - Smuggling

Average Statutory Import Tariff Rate



Tariff Revenue as a Percentage of Value of Imports



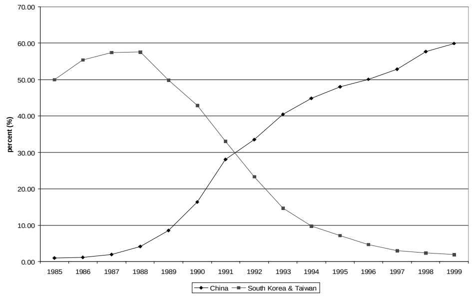
Some Features of Structure Change

- Export commodities
  - Resource intensive products declined
  - Labor intensive products increased
  - Capital intensive products also increased
- Export regions
  - Concentrated in some coastal provinces
  - Guangdong and Fujian account for 1/2 of total export
  - Shandong, Jiangsu, Zhejiang grow fast, but not in export

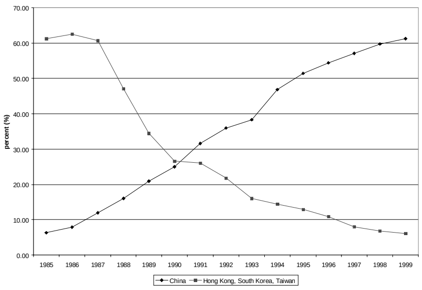
Some Features of Structure Change

- Production displacement
  - China's increased market share in export is matched by the declining shares of Hong Kong and Taiwan
  - A natural process and Hong Kong and Taiwan firms benefit too

Sources of U.S. Footwear Import



Sources of U.S. Imports of Toys, Games and Sporting Goods



China's Motivation to Enter WTO

- Trade and growth
  - China's trade integration with the world remains shallow
  - Growth slow down after Asian financial crises calls for more foreign investment
- Reform and restructuring
  - Use WTO as an anchor to push for further reform
  - Introducing international competition
- Joining the international club
  - Being part of the civilized world
  - More weight in international affairs
  - China is an exception among developing countries to enthusiastically and unconditionally embrace globalization

Difficulties of Negotiation

- 15 years of negotiation (July 1986-Dec. 2001)
  - China's economy is not a complete market economy
  - China's economy is a developing economy
  - China's economy is large and growing fast
- Forces against China's accession to WTO
  - Domestic
    - Short term costs
    - Long term nationalist interests
  - Abroad
    - Non-economic reasons
    - Economic reasons

Terms of China's Accession to WTO: Market Access

- Tariff reduction
  - Average of 14.5% by 2004
  - Average of 9.4% by 2005
- Removing non-tariff barriers
  - Eliminate most licensing, quotas, other quantitative restrictions by 2005
  - Eliminate some quotas or increase the quotas upon accession

Terms of China's Accession to WTO: Market Access

- Services:
  - Telecommunications (internet content and service provider)
  - Financial services (banking, insurance, securities)
  - Audiovisual (media)
  - Professional services (accounting, consultant, legal)
  - Wholesale and retail trade (including after-sale service, repair, maintenance, and transportation)
- In some cases, up to 49% or 50% of ownership share (e.g., telecommunication)

Terms of China's Accession to WTO: Market Access

- Agriculture
  - Reduction of tariff from 22% to 17.5%
  - Adopt "tariff-rate quota" (TRQ) system: low tariff within the quota, higher tariff out-of-quota
  - The purpose of tariff-rate quota is to assure minimum market access
  - Example: wheat
    - Quota tariff: 1%
    - Initial quota: 7.3 million ton
    - Ultimate quota: 9.3 million ton
    - 1998 import: 1.5 million ton
  - Ending state monopoly of grain trading by granting import quotas to private traders

Terms of China's Accession to WTO: Protocol Issues

- Some are universal terms
  - Transparency in trade administration (laws, regulations)
  - Judiciary review
  - Trade-Related Investment Measures
    - No local content requirements
    - No forced technology transfer and no offsets arrangements
  - Government procurement
    - whenever a government body or authority procures goods or services from foreign suppliers, it must provide all potential foreign suppliers with an equal opportunity to compete for the business via bidding or other similar process

Terms of China's Accession to WTO: Protocol Issues

- Some are not
  - China has accepted terms far beyond those by other countries (e.g., eliminating agriculture subsidies)
  - Some are even in violation of the WTO principle (e.g., discriminatory treatment in safeguard and anti-dumping)

Terms of China's Accession to WTO: Protocol Issues

- Safeguards
  - A country may impose quantitative restrictions on imported goods provided certain conditions are met, which are unusually strict
  - But relatively easy for a country to impose quantitative restrictions for goods from China for 12 years
  - Example: the injury standard in the product-specific safeguard
    - market disruption standard
    - serious injury standard
  - Exception to the nondiscriminatory principle: restrictions may apply only on goods originating in China
  - China's retaliation is more restricted
  - Textile and apparel quotas continue until 2008, after general expiration of quotas in 2005

Terms of China's Accession to WTO: Protocol Issues

- Antidumping
  - WTO allows countries to impose countervailing duties on imports when a firm is selling a product abroad at less than its "normal value"
  - Normal value is the price at which the good is sold in the home country or in a third country or the cost of producing the product, plus reasonable amounts for administration, selling and other costs, and profit
  - China is treated as "no-market economy"
    - Domestic production costs cannot be used
    - Disadvantage to China's labor intensive products

Implications of WTO Membership for China

- Manufacturing: automobile
  - highly protected sector
  - Tariff reduction from 80-100% in 2000 to 25% in 2006
  - Small scale: 120 vehicle manufactures, average production is about 100,000 from the top 13
  - Predicted 1/2 million job loss after WTO
  - Big surprise: boom years after WTO

Implications of WTO Membership for China

- Agriculture
  - China does not have advantage in land-intensive products such as grain
  - More imports of grain after WTO
  - Predicted more than 11 million job losses
  - But other labor intensive products

Implications of WTO Membership for China

- Financial services
  - Greatest risks and challenges
  - Banking
    - Foreign banks competition
    - Predicted 1 million job loss in state banks
    - Foreign banks conduct local currency enterprise business in 2 years and household business in 5 years
    - Likely in wholesale market rather than retail deposits
  - Insurance
  - Securities