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China's Economic Conditions

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SUMMARY

Since the initiation of economic reforms in 1979, China has become one of the world's fastest growing economies. From 1979-2002, China's real GDP rose at an average annual rate of 9.3%; it rose by an estimated 8.0% in 2002. Many economists speculate that China could become the world's largest economy at some point in the near future, provided that the government is able to continue and deepen economic reforms, particularly in regards to its efficient state-owned enterprises (SOEs) and state banking system. Progress in reforming these sectors in recent years has been somewhat mixed.

After many years of negotiations, China became a member of World Trade Organization (WTO) on December 11, 2001. WTO accession commits China to significantly reducing a wide variety of tariff and non-tariff barriers over the next few years. Legislation (H.R. 4444) authorizing the President to grant permanent normal trade relations (PNTR) status to China (once it joined the WTO) was enacted into law on October 10, 2000 (P.L. 106-286). Following China's WTO accession in December 2001, President Bush extended PNTR status to China which became effective in January 2002.

If fully implemented, the terms of China's WTO accession will likely have a significant impact on China's economy. The level of Chinese trade protectionism will be greatly diminished over then next few years, and nearly all sectors of China's economy (including agriculture, manufacturing, and services) will increasingly be subject to great competition (or in some cases, competition for the first time) from foreign firms. Several of China's heavily protected industries, such as autos, and certain agricultural sectors, could be negatively affected by China's WTO membership. China's labor-intensive industries, especially textiles and apparel, will benefit significantly with China's WTO accession.

Although Chinese government leaders have stated that WTO accession will force Chinese firms to become more productive and competitive (and hence boost China's long-term economic growth), they have also expressed concern that required reforms will cause employment disruptions in several sectors, which could result in social unrest. A major challenge for the government is to develop an adequate social safety net to assist laid-off workers.

China's economy remained relatively healthy in 2002, despite economic slowdowns in other parts of the world. Foreign investment continued to pour into China, and the Chinese government effectively used public spending to boost the economy. However, painful economic reforms will be necessary to keep the economic strong in 2003 and beyond.

A main concern for Congress is to ensure that China fully complies with its WTO commitments.

Most Recent Developments

On January 9, 2003, the United Nations reported that in 2002, China had replaced the United States as the world's largest recipient of foreign direct investment.

On November 8, 2002, Chinese President Jiang Zemin formally proposed at the 16th National Congress of the Chinese Communist Party that the Party constitution be amended to allow private entrepreneurs to join the Party (based on Jiang's "Three Represents" theory). The amendment was adopted on November 11.

On November 4, 2002, China and the Association of Southeast Asian Nations (ASEAN) formally agreed to begin negotiations to create a free trade area.

Background and Analysis

An Overview of China's Economic Development

China's Economy Prior to Reforms

Prior to 1979, China maintained a centrally planned, or command, economy. A large share of the country's economic output was directed and controlled by the state, which set production goals, controlled prices, and allocated resources throughout most of the economy. During the 1950s, all of China's individual household farms were collectivized into large communes. To support rapid industrialization, the central government during the 1960s and 1970s undertook large-scale investments in physical and human capital. As a result, by 1978 nearly three-fourths of industrial production was produced by centrally controlled state-owned enterprises (SOEs) according to centrally planned output targets. Private enterprises and foreign invested firms were nearly non-existent. A central goal of the Chinese government was to make China's economy relatively self-sufficient. Foreign trade was generally limited to obtaining only those goods that could not be made or obtained in China.

Government policies kept the Chinese economy relatively stagnant and inefficient, mainly because there were few profit incentives for firms and farmers, competition was virtually nonexistent, and price and production controls caused widespread distortions in the economy. Chinese living standards were substantially lower than those of many other developing countries. The Chinese government hoped that gradual reform would significantly increase economic growth and raise living standards.

The Introduction of Economic Reforms

Beginning in 1979, China launched several economic reforms. The central government initiated price and ownership incentives for farmers, which enabled them to sell a portion of their crops on the free market. In addition, the government established four special economic zones for the purpose of attracting foreign investment, boosting exports, and importing high technology products into China. Additional reforms followed in stages that sought to decentralize economic policymaking in several economic sectors, especially trade. Economic control of various enterprises was given to provincial and local governments, which were generally allowed to operate and compete on free market principles, rather than under the direction and guidance of state planning. Additional coastal regions and cities were designated as open cities and development zones, which allowed them to experiment with free market reforms and to offer tax and trade incentives to attract foreign investment. In addition, state price controls on a wide range of products were gradually eliminated.

China's Economic Growth Since Reforms: 1979-2002

Since the introduction of economic reforms, China's economy has grown substantially faster than during the pre-reform period (see **Table 1**). Chinese statistics show real GDP from 1979 to 2002 growing at an average annual rate of 9.3%, making China one of the world's fastest growing economies. The World Bank estimates that China's economic reforms have raised nearly 200 million people out of extreme poverty. The Chinese government estimates that real GDP rose by 8.0% in 2002. DRI-WEFA, an economic consulting firm, projects China's real GDP growth at 7.8.% in 2003.

Table 1. China's Average Annual Real GDP Growth Rates: 1960-2002

Time Period	Average Annual % Growth
1960-1978 (pre-reform)	5.3
1979-2002 (post-reform)	9.3
1990	3.8
1991	9.3
1992	14.2
1993	13.5
1994	12.7
1995	10.5
1996	9.7
1997	8.8
1998	7.8
1999	7.1
2000	8.0
2001	7.3
2002 (estimate)	8.0

Sources: Official Chinese government data reported by the World Bank, *World Development Report* (various issues).

Causes of China's Economic Growth

Economists generally attribute much of China's rapid economic growth to two main factors: large-scale capital investment (financed by large domestic savings and foreign investment) and rapid productivity growth. These two factors appear to have gone together hand in hand. Economic reforms led to higher efficiency in the economy, which boosted output and increased resources for additional investment in the economy.

China has historically maintained a high rate of savings. When reforms were begun in 1979, domestic savings as a percentage of GDP stood at 32%. However, most Chinese savings during this period were generated by the profits of SOEs, which were used by the central government for domestic investment. Economic reforms, which included the decentralization of economic production, led to substantial growth in Chinese household savings (which now account for half of Chinese domestic savings). As a result, savings as a percentage of GDP has steadily risen; it was 40.1% in 2001, among the highest savings rates in the world.

China's trade and investment reforms and incentives led to a surge in foreign direct investment (FDI), which has been a major source of China's capital growth. Annual utilized FDI in China grew from $636 million in 1983 to nearly $53 billion in 2002. It is estimated that there are over 420,000 foreign-funded enterprises in China, with a cumulative level of FDI of $453 billion. FDI in China in 2002 grew by nearly 13%, an impressive figure considering that worldwide FDI in developing countries fell by over 25%.

Analysts predict that FDI will continue to pour into China as investment barriers are reduced under China's WTO commitments and Chinese demand for imports continue to increase. The United Nations estimates that in 2002, China replaced the United States as the world's largest recipient of FDI. The Chinese government predicts that FDI will reach over $100 billion by 2006.

Nearly half of FDI in China has come from Hong Kong. The United States is the second largest investor in China, accounting for 8.7% ($34.4 billion) of total FDI in China from 1979 to 2001 (see **Table 2**). U.S. FDI in China for 2001 was $4.4 billion, accounting for 9.4% of FDI for that year.

Table 2. Major Foreign Investors in China: 1979-2001

($ billions and % of total)

Country	Cumulative Utilized FDI: 1979-2001		Utilized FDI in 2001	
	Amount ($billions)	% of Total	Amount ($billions)	% of Total
Total	395.5	100.0	46.9	100.0
Hong Kong	187.7	47.5	16.7	35.6
United States	34.4	8.7	4.4	9.4
Japan	32.4	8.2	4.3	9.2
Taiwan	29.2	7.4	3.0	6.4
Singapore	13.0	3.3	2.1	4.5

Source: Chinese government statistics. Top 5 investors according to cumulative FDI from 1979-2001.

Several economists have concluded that productivity gains (i.e., increases in efficiency in which inputs are used) were another major factor in China's rapid economic growth. The improvements to productivity were largely caused by a reallocation of resources to more productive uses, especially in sectors that were formally heavily controlled by the central government, such as agriculture, trade, and services. For example, agricultural reforms boosted production, freeing workers to pursue employment in more productive activities in the manufacturing sector. China's decentralization of the economy led to the rise of non-state enterprises, which tended to pursue more productive activities than the centrally controlled SOEs. Additionally, a greater share of the economy (mainly the export sector) was exposed to competitive forces. Local and provincial governments were allowed to establish and operate various enterprises on market principles, without interference from the central government. In addition, FDI in China brought with it new technology and processes that boosted efficiency.

Measuring the Size of China's Economy

The actual size of the China's economy has been a subject of extensive debate among economists. Measured in U.S. dollars using nominal exchange rates, China's GDP in 2001 was about $1.2 trillion; its per capita GDP (a commonly used living-standards measurement) was $875. Such data would indicate that China's economy and living standards were significantly lower than those of the United States and Japan, considered to be the number one and number two largest economies, respectively (see **Table 3**).

Many economists, however, contend that using nominal exchange rates to convert Chinese data into U.S. dollars substantially underestimates the size of China's economy. This is because prices in China for many goods and services are significantly lower than those in the United States and other developed countries. Economists have attempted to factor in these price differentials by using a purchasing power parity (PPP) measurement, which attempts to convert foreign currencies into U.S. dollars based on the actual purchasing power of such currency (based on surveys of the prices of various goods and services) in each respective country. This PPP exchange rate is then used to convert foreign economic data in national currencies into U.S. dollars.

Because prices for many goods and services are significantly lower in China than in the United States and other developed countries (while prices in Japan are higher), the PPP exchange rate raises the estimated size of Chinese economy to about $5.6 trillion, significantly higher than Japan's GDP in PPPs ($3.5 trillion), and about half the size of the U.S. economy. PPP data also raise China's per capita GDP to $4,300. The PPP figures indicates that, while the size of China's economy is substantial, its living standards fall far below those of the U.S. and Japan. The International Monetary Fund estimates that (using PPP measurements) China could surpass the United States as the world's largest economy as early as the year 2007. Yet, even if that were to occur, it would take China significantly longer to achieve U.S. standard of living levels.

Table 3. Comparisons of U.S., Japanese, and Chinese GDP and Per Capita GDP In Nominal U.S. Dollars and PPP: 2001

Country	Nominal GDP ($Billions)	GDP in PPP ($Billions)	Nominal Per Capita GDP	Per Capita GDP in PPP
U.S.	10,082	10,082	36,300	36,300
Japan	4,148	3,450	32,636	27,200
China	1,179	5,560	923	4,300

Sources: DRI-WEFA, Country Outlook, First Quarter, 2002 and CIA, World Factbook.
Note: PPP data for China should be interpreted with caution. China is not a fully developed market economy; the prices of many goods and services are distorted due to price controls and government subsidies.

China's Trade Patterns

Economic reforms have transferred China into a major trading power. Chinese exports rose from $14 billion in 1979 to $326 billion in 2002, while imports over this period grew from $16 billion to $295 billion (see **Table 4**). China is currently the world's 6th largest trading nation (based on 2001 data). Despite the worldwide economic slowdown, China's exports in 2002 rose by 22.3%, while imports grew by 21.2%.

Historically, China has run trade deficits in some years and surpluses in others. However, over the past 9 years, China has run trade surpluses; in 2002 that surplus was $30.5 billion. Merchandise trade surpluses and large-scale foreign investment have enabled China to accumulate the world's second largest foreign exchange reserves, estimated to have reached $243 billion in June 2002.

Table 4. China's Merchandise World Trade: 1979-2002
($ billions)

	Exports	Imports	Trade Balance
1979	13.7	15.7	-2.0
1980	18.1	19.5	-1.4
1981	21.5	21.6	-0.1
1982	21.9	18.9	2.9
1983	22.1	21.3	0.8
1984	24.8	26.0	-1.1
1985	27.3	42.5	-15.3
1986	31.4	43.2	-11.9
1987	39.4	43.2	-3.8
1988	47.6	55.3	-7.7
1989	52.9	59.1	-6.2
1990	62.9	53.9	9.0
1991	71.9	63.9	8.1
1992	85.5	81.8	3.6
1993	91.6	103.6	-11.9
1994	120.8	115.6	5.2
1995	148.8	132.1	16.7
1996	151.1	138.8	12.3
1997	182.7	142.2	40.5
1998	183.8	140.2	43.6
1999	194.9	165.8	29.1
2000	249.2	225.1	24.1
2001	266.2	243.6	22.6
2002	325.6	295.2	30.4

Source: International Monetary Fund, Direction of Trade Statistics and official Chinese statistics.

China's Major Trading Partners

China's trade data often differ significantly from those of its major trading partners. This is due to the fact that a large share of China's trade (both exports and imports) passes through Hong Kong (which reverted back to Chinese rule in July 1997, but is treated as a separate customs area by most countries, including China and the United States). China treats a large share of its exports through Hong Kong as Chinese exports to Hong Kong for statistical purposes, while many countries that import Chinese products through Hong Kong generally attribute their origin to China for statistical purposes. According to Chinese trade data, its top five trading partners in 2001 were Japan, the United States, the European Union

(EU), Hong Kong, and South Korea (see **Table 5**). Chinese data show the United States as China's largest destination for its exports and the fifth largest source of its imports.

Table 5. China's Top 10 Trading Partners: 2001

($ billions)

Country	Total Trade	Chinese Exports	Chinese Imports	China's Trade Balance
All Countries	509.8	266.2	243.6	22.6
Japan	87.8	45.0	42.8	2.2
U.S.	80.5	54.3	26.2	28.1
EU	76.6	40.9	35.7	5.2
Hong Kong	56.0	46.5	9.4	37.1
S. Korea	35.9	12.5	23.4	-10.9
Taiwan	32.3	5.0	27.3	-22.3
Singapore	10.9	5.8	5.1	0.7
Russia	10.7	2.7	8.0	-5.3
Malaysia	9.4	3.2	6.2	-3.0
Australia	9.0	3.6	5.4	-1.8

Source: Official Chinese trade data.
Note: Chinese data on its bilateral trade often differ substantially from the official trade data of other countries on their trade with China.

U.S. trade data indicate that the importance of the U.S. market to China's export sector is likely much higher than is reflected in Chinese trade data. Based on U.S. data on Chinese exports to the United States (which, as noted, do not agree with Chinese data), and Chinese data on total Chinese exports, it is estimated that Chinese exports to the United States as a share of total Chinese exports grew from 15.3% in 1986 to an estimated 38.4.% in 2001.

A growing level of Chinese exports are from foreign funded enterprises (FFEs) in China. According to Chinese data, the share of total Chinese exports produced by FFEs rose from 0.1% in 1980 to 47.9% in 2000. FFEs also accounted for 52.1% of total Chinese imports. A large share of these FFEs are owned by Hong Kong and Taiwan investors, many of whom have shifted their labor-intensive, export-oriented, firms to China to take advantage of low-cost labor. A significant share of the products made by such firms are exported to the United States.

Major Chinese Trade Commodities

China's abundance of cheap labor has made it internationally competitive in many low cost, labor-intensive, manufactures. As a result, manufactured products comprise an increasingly larger share of China's trade. The share of Chinese manufactured exports to total exports rose from 50% in 1980 to 90% in 2000, while manufactured imports as a share of total imports rose from 65% to 84%. A large share of China's manufactured imports are comprised of intermediates (e.g., chemicals, electronic components, and textile machinery) used in manufacturing products in China.

Major Chinese imports in 2001 included mechanical and electrical equipment, electronic integrated circuits and micro-assemblies, crude oil, plastics, and steel products (see **Table 6**). China's major 2001 exports included mechanical and electrical products, electric and electronic products, garments and clothing, computer and telecommunications products, and textiles (see **Table 7**).

Table 6. Major Chinese Imports: 2001

Commodity	**Total ($Billions)**	**% of Total Exports**
Mechanical & electrical equipment	120.5	49.5
Electronic integrated circuits & micro-assemblies	16.6	6.8
Crude oil	11.7	4.8
Primary plastics	11.7	4.8
Steel & steel products	9.0	3.7
Total top 5	169.5	69.6

Source: Official Chinese trade data.

Table 7. Major Chinese Exports: 2001

Commodity	**Total ($Billions)**	**% of Total Imports**
Mechanical & electrical products	118.8	44.6
Electric & electronic products	51.3	19.3
Garments & clothing accessories	36.6	13.7
Computer & telecommunications products	36.2	13.6
Textiles, yarns, & fabrics	16.8	6.3
Total top 5	259.7	97.5

Source: Official Chinese trade statistics.

Major Challenges Facing the Chinese Economy

China's economy has shown remarkable economic growth over the past several years, and many economists project that it will enjoy fairly healthy growth in the near future. DRI-WEFA, a private international forecasting firm, projects China's GDP will grow at an average annual rate of over 7.0% over the next several years. At this rate, China would be able to double its GDP every 10 years. However, economists caution that these projections are likely to occur only if China continues to make major reforms to its economy. Failure to implement such reforms could endanger future growth.

- **State-owned enterprises (SOEs)**, which account for about one-quarter of Chinese industrial production and employ nearly two-thirds of urban workers, put an increasingly heavy strain on China's economy. Over half are believed to lose money and must be supported by subsidies, mainly through state banks. Government support of unprofitable SOEs diverts resources away from potentially more efficient and profitable enterprises. In addition, the poor financial state of many SOEs makes it difficult for the government to reduce trade barriers out of fear that doing so would lead to wide-spread bankruptcies of many SOEs.

- **The banking system** faces several major difficulties due to its financial support of SOEs and failure to operate solely on market-based principles. China's banking system is regulated and controlled by the central government, which sets interest rates and attempts to allocate credit to certain Chinese firms. The central government has used the banking system to keep afloat money-losing SOEs by pressuring state banks to provide low interest loans, without which a large share of the SOEs would likely go bankrupt. Currently, over 50% of state-owned bank loans now go to the SOEs, even though a large share of loans are not likely to be repaid. The high volume of bad loans now held by Chinese banks (estimated to total $250 billion) poses a serious threat to China's banking system. Three out of the four state commercial banks are believed to be insolvent. The precarious financial state of the Chinese banking system has made Chinese reformers reluctant to open its banking sector to foreign competition Corruption poses another problem for China's banking system because loans are often made on the basis of political connections. This system promotes widespread inefficiency in the economy because savings are generally not allocated on the basis of obtaining the highest possible returns.

- **China's agricultural system** is highly inefficient due to government policies that seek to maintain a 95% self-sufficiency rate in grains, mainly through the extensive use of subsidies and restrictive trade barrier. These policies divert resources from more productive economic sectors and keep domestic prices for many agricultural products above world prices.

- **Infrastructure bottlenecks**, such as inadequate transportation and energy systems, pose serious challenges to China's ability to maintain rapid economic growth. China's investment in infrastructure development has failed to keep pace with its economic growth The World Bank estimates that transportation bottlenecks reduce China's GDP growth by 1% annually. Chronic power shortages are blamed for holding China's industrial growth to 80% of its potential. Transportation bottlenecks and energy shortages also add inflationary strains to the economy because supply cannot keep up with demand.

- **The lack of the rule of law** in China has led to widespread government corruption, financial speculation, and mis-allocation of investment funds. In many cases, government "connections," not market forces, are the main determinant of successful firms in China. Many U.S. firms find it difficult to do business in China because rules and regulations are generally not consistent or transparent, contracts are not easily enforced, and intellectual property rights are not protected (due to the lack of an independent judicial system). The lack of rule of law in China limits competition and undermines the efficient allocation of goods and services in the economy. In addition, the Chinese government does not accept the concept of private ownership of land and assets in China

- **High trade barriers** are maintained by the government in large part to protect domestic firms from foreign competition. Such policies have several negative effects. They prevent the most efficient utilization of resources in the economy, give domestic firms less incentive to improve efficiency, and raise prices for Chinese consumers.

- **A wide variety of social problems** have arisen from China's rapid economic growth and extensive reforms, including pollution, a widening of income disparities between the coastal and inner regions of China, and a growing number of bankruptcies and worker layoffs. This poses several challenges to the government, such as enacting regulations to control pollution, focusing resources on economic development in the hinterland, and developing modern fiscal and tax systems to address various social concerns (such as poverty alleviation, health care, education, worker retraining, pensions, and social security). In addition, the United Nations in a June 2002 report stated that China was on the verge of "catastrophe that could result in unimaginable suffering, economic loss and social devastation," due to the rapid rise of HIV/AIDS in China.

Reform of State Owned Enterprises

The Chinese leadership has been talking about undertaking major reforms of unprofitable SOEs for the past several years, but has been hesitant to act due to concerns that reforms would lead to widespread bankruptcies and cause political instability. However, the Chinese government has acknowledged that support of SOEs has put a heavy drain on the economy and cannot be maintained indefinitely. As a result, reform of SOEs has been made a top priority. In September 1997, Chinese President Jiang Zemin stated that China would take steps which, if implemented, would essentially privatize (although referred to by the Chinese as "public ownership") all but 1,000 out of an estimated 308,000 SOEs by cutting off most government aid and forcing them to compete on their own. This policy was re-affirmed and expanded upon by Premier Zhu Rongji in March 1998. Under this plan, some unprofitable SOEs would be closed, while others would be merged with more profitable enterprises. Many firms would be allowed to issue stock in order to raise funds. SOEs would also be released from the responsibility of providing subsidized housing. Finally, the government announced that SOEs would no longer receive preferential treatment by state banks for loans.

Reform of the SOEs over the past few years has been relatively uneven. On the one hand, the government has sought to improve SOE efficiency by significantly reducing the number of redundant workers (since 1998, over 26 million SOE workers were laid off) and cutting back on the level of free services (such as education, housing, and health care) given to remaining workers. Workers who have been laid off from SOEs have been encouraged by the government to find jobs in the private sector or to start their own businesses. Individuals starting their own businesses have been given tax breaks. Prior to China's WTO accession, the Chinese government announced plans to move ahead with further SOE reform to make them even less reliant on government support. In many cases this involved letting some SOEs go bankrupt, merging other firms together, and encouraging others to raise funds on their own through the issuance of stock. However, the government also increased pressure on state banks to extend more loans to SOEs in order for them to modernize their operations. In December 2002, the Chinese government reported that SOEs in 2002 had achieved "record profits," however many analysts doubt the veracity of these statements since most SOEs do not use modern accounting standards and many falsely report making profits when in fact the firm lost money.

Reform of the Banking System

Chinese officials have indicated a desire to strengthen and reform its banking system. In January 1998, the central government announced it would implement new reforms to enhance the power of the central bank over the provincial and state banks and to improve the management systems of all Chinese banks. Such reforms would attempt to lessen the power of local officials to pressure banks into making "bad loans." In addition, the government has indicated that banks will be allowed to make bank loan decisions based on commercial, rather than political, considerations. Finally, on March 2, 1998, the government announced plans to issue bonds to recapitalize the state banks to enable them to write off bad loans. Chinese officials claim their long-term goal is to develop a modern banking system similar to that of the U.S. Federal Reserve system. However, a slowdown in the economy during the Asian financial crisis caused the central government to resume pressure on the state banks to continue to lend money to money-losing enterprises. In preparation for WTO entry, the government reaffirmed its commitment to making its banking system more responsive to market forces. It has continued re-capitalizing the banks to enable them to write off bad loans, financed largely by the issuance of government bonds. It also issued guidelines stating that new loans should be based on commercial criteria. Many China analysts believe the banking system to be the most unstable sector of China's economy. One analysis by Goldman Sachs estimated that China would need at least $290 billion to make its banking system solvent.

Infrastructure Development

The Chinese government's concerns over the disruptive effects of economic reforms and sluggish domestic demand have led the government to significantly boost spending on infrastructure spending. Chinese officials announced in February 1998 their intentions to spend $750 billion on infrastructure development over the next 3 years; in September 1998, Chinese officials indicated that $1.2 trillion would be spent. Many analysts, however, have questioned China's ability obtain funding for such a massive financial undertaking in such a short period of time. The issuance of government bonds has become a major source of finance for infrastructure, which has increased government budget deficits. It appears, however, that infrastructure spending by the government has been a major contributor to China's economic growth over the past few years. However, the government is concerned over the potentially destabilizing effects of increased debt. Efforts have been made in recent years to improve tax collection with mixed success.

Major Issues in China-U.S. Economic Relations

China's growth as a major economic and trading power has expanded U.S.-China commercial ties, although disputes have arisen over a number of issues, such as trade investment barriers, China's most-favored-nation (MFN), or normal trade relations (NTR), status, and the terms for China's accession to the World Trade Organization (WTO). The World Bank projects that by the year 2020, China will be the world's second largest trading economy after the United States. China's continued rapid growth has increased concerns among U.S. policymakers that China's trade regime must be brought in compliance with multilateral rules to ensure that U.S. firms are given access to China's growing markets.

China's Accession to the World Trade Organization

China has made its accession to the World Trade Organization (WTO) a major priority. On November 15, 1999, U.S. and Chinese officials reached a bilateral agreement on China's WTO bid. China completed its bilateral WTO negotiations when it signed an agreement with Mexico on September 13, 2001, the last of the 37 WTO members that had requested such an accord. On September 17, 2001, China completed negotiations with the WTO Working Party handling its WTO application. China's WTO membership was formally approved by the WTO on November 10, 2001, and on November 11, China informed the WTO that it had ratified the WTO agreements. As a result, China officially joined the WTO on December 11, 2001.

China's Normal Trade Relations Status

On July 22, 1998, President Clinton signed into law P.L. 105-206 (a bill to reform the Internal Revenue Service), which contained a provision replacing the term "most-favored nation (MFN) status" with the term "normal trade relations" (NTR) in U.S. trade law. This change was made to help dispel the belief of some that the term "MFN status" indicates a preferential trade status, when in fact it indicates the trade status afforded by the United States to all but a handful of countries. Prior to January 2002, U.S. law (Title IV of the 1974 Trade Act, as amended) required China's NTR status to be renewed on an annual basis (based on freedom-of-emigration requirements of the Jackson-Vanik amendment).

From 1980 (when NTR status was restored to China after being suspended in 1951) to 1989, the renewal of China's NTR status was relatively noncontroversial and was relatively unopposed by Congress. However, congressional concern over the Tiananmen Square incident in 1989 and subsequent crackdown on human rights led many Members to support legislation terminating the extension of China's NTR status or to condition that status on additional requirements, mainly dealing with human rights. While none of these measures were enacted, many Members sought to use the annual renewal of China's NTR status as a focal point to express concerns, as well as to pressure the executive branch, over a wide range of Chinese trade (e.g., trade barriers and failure to protect intellectual property rights) and non-trade (e.g., human rights, prison labor, Taiwan security, and weapons proliferation) issues. Several members opposed such linkage, arguing that it had little effect on Chinese policies, and that the often rancourous congressional debate over China's trade status undermined long-term U.S.-Chinese relations and added uncertainty to the trade relationship.

In order to ensure that the WTO agreements would apply between the United States and China once China gained admittance to the WTO, Congress passed legislation (H.R. 4444, P.L. 106-286) granting authority to the President to extend permanent normal trade relations (PNTR) status to China upon its entry to the WTO. (Additionally, the law contains a number of provisions dealing with such issues as human rights, Chinese prison labor exports, and Chinese compliance with WTO rules.) On December 27, 2001, President Bush issued a proclamation extending PNTR status to China, effective January 1, 2002.

Outlook for China's Economy

The short term outlook for the Chinese economy is difficult to predict, due largely to uncertainties over the state of the global economy over the next few years. China's economy has held up remarkably well in the face of economic slowdowns in the United States and its other major trading partners. Foreign investment has continues to pour into China, which has helped boost Chinese exports. In addition, the Chinese government has continued a policy of boosting the economy through public spending. As a result, China's real GDP is projected to rise by around 7.8% in 2003. Long term growth will be largely determined by the government's ability to reform the SOEs to make them profitable, and to reform the banking system to make it more responsive to market forces.

China's efforts to join the WTO appear to represent a major commitment on the part of the Chinese government to significantly reform its economy and provide greater access to its markets. Some China observers believe that the Chinese government considers accession to the WTO as an important, though painful, step towards making Chinese firms more efficient and able to compete in world markets. In addition, the government hopes that liberalized trade rules will boost foreign investment in China, which has declined in recent years. Economists argue that, over the long-run, greater market openness in China will boost competition, improve productivity, and lower costs for consumers, as well as for firms using imported goods as inputs for production. Economic resources will more likely be redirected away from money-losing activities (such as SOEs) to more profitable ventures, especially those in China's growing private sector. As a result, China is likely experience more rapid economic growth (than would occur under current economic policies). A study performed by the Chinese government estimates that WTO membership would boost China's GDP by 1.5% annually by 2005 and thereafter. On the other hand, however, the Chinese government is deeply concerned with maintaining social stability. Many analysts warn that, if trade liberalization were followed by a severe economic slowdown, leading to widespread bankruptcies and layoffs, the Chinese government might choose to halt or delay certain economic reforms, rather than risk possible political upheaval. An additional problem posed by China's WTO accession will be to get Chinese local and provincial governments to adhere to WTO rules, since many of them impose a variety of protectionist policies to protect firms under their jurisdiction.

On November 8, 2002, Chinese President Jiang Zemin formally proposed at the 16th National Congress of the Chinese Communist Party that the Party constitution be amended to allow private entrepreneurs to join the Party (based on Jiang's "Three Represents" theory); the amendment was adopted on November 11. This step reflects the Chinese Communist Party recognition of the growing importance of the private sector to China's economy, but also poses a dilemma for the Party since private firms may pose a competitive threat to state-owned firms (and could become a significant political force as well). Many economists argue that increased competition from foreign firms, as well as from China's domestic private sector, may force the Chinese government to eventually choose between privatization and bankruptcy to keep many unprofitable SOEs afloat.