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**CHINA'S WTO ACCESSION:
FOREIGN INVESTMENT, GOVERNMENT
PROCUREMENT, GRAIN SELF-SUFFICIENCY,
AND LABOUR STANDARDS**

Edited by Kym Anderson

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by **Kym Anderson**

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Editor's Introduction

Kym Anderson

In late 1995 the University of Adelaide established a Graduate Diploma in International Economics (GDIE) to offer training for trade policy analysts and diplomats interested in furthering their economics skills and their understanding of the global trading system. The papers in this collection were presented as term papers by four groups of students in the 1998 class. All relate to China's attempt to seek membership to the World Trade Organisation.

The first, on "China's Foreign Investment Regime and the TRIMs Agreement", by Xiaohong Dang, Zhentao Li, and Ling Xu, points to areas where China's policies on foreign-invested enterprises will require modification in order to be consistent with the WTO's agreement on trade-related investment measures. They include the use of rules requiring (a) minimum local content for parts used in certain industries such as motor vehicle assembling, (b) minimum shares of production that should be exported, and (c) foreign exchange for purchasing imported inputs to be earned from the enterprise's export sales of its output. Each of these rules is shown to reduce the efficiency of resource use in China, as well as to distort China's foreign trade and thereby upset its trading partners. Reforming those rules to make them consistent with the WTO's TRIMs agreements will, therefore, provide economic benefits both to China and other countries, as well as reduce the barriers to China's accession to WTO.

The second paper is on China and the WTO's plurilateral Agreement on Government Procurement (AGP), by Zhouxiang Lu, Zhiyong Pei, and Lingyan Zhu. Since the AGP has not yet been signed by all WTO members, China's WTO accession will not necessarily require it to sign. Even so, the country needs to contemplate the pros and cons of being a signatory, in part because members might require China to sign it as a condition of accession, and in part because the AGP might be transformed into a multilateral agreement in the future. This paper explores the benefits that China would enjoy as a WTO member if it was a signatory to the AGP, as well as the potential difficulties that might cause.

Implications of WTO Accession for China's Grain Self-sufficiency, by Wei Ding, Hai Hu, and Linlin Liu, is the topic of the third paper. This paper challenges the view held by some in China that WTO membership will so limit China's degrees of freedom in agricultural policy making as to ensure that grain self sufficiency declines to an unacceptable level. It points out that there is ample scope for China to boost grain productivity and self sufficiency by removing some of its market impediments and using WTO-consistent policy measures to increase investments in agricultural research and infrastructure and improve the functioning of land and other input markets.

The final paper is on "Labour Standards, WTO, and China", by Fuying Li,

Chenhai Miao, and Gaojian Peng. They analyse the economics of enforcing higher labour standards in developing countries as well as legal and institutional aspects of this issue – which is one that has come under discussion repeatedly among WTO members in recent times even though it has no formal place on the WTO agenda at this stage. The paper argues that the ILO rather than the WTO is the most appropriate international forum to discuss this matter. In examining the implications for China, the paper notes that China's labour standards are rising and can be expected to continue to rise with economic development, and that it might be counter-productive to interrupt this natural process by imposing excessively high standards from outside.

The GDIE students who authored these papers are trade diplomats from China on AusAID scholarships. They and the University of Adelaide are grateful for that financial support from AusAID, the Australian Government's technical cooperation agency.

China's foreign investment regime and the TRIMs agreement

Xiaohong Dang, Zhentao Li, and Ling Xu

University of Adelaide

Inward foreign investment has greatly contributed to the economic development of China since her opening up to the outside world in 1978. As China's economic reform advances further, foreign invested enterprises (FIEs) are playing an increasingly prominent role in her economic growth. To generate a sound and stable investment environment, a series of laws and regulations on foreign investment in China have been promulgated. However, as China endeavours to enter the World Trade Organisation (WTO), the question arises as to whether current policies concerning FIE operations are inconsistent with the WTO's Agreement on Trade-Related Investment Measures (TRIMs). This paper examines three major areas of disparity between China's domestic rulings and TRIMs: local content schemes, export ratio rules, and the requirement that firms at least balance their foreign exchange receipts and expenditures. Each of these rules is shown to reduce the efficiency of resource use in China, as well as to distort China's foreign trade and thereby upset its trading partners. Reforming those rules to make them consistent with the WTO's TRIMs agreements will, therefore, provide economic benefits both to China and other countries, as well as reduce the barriers to China's accession to WTO.

Local content schemes

According to Chinese Law on Chinese-Foreign Equity Joint Ventures, "an equity joint venture shall give first priority to Chinese sources in its purchase of required raw and semi-processed materials". In practice this has meant that a certain proportion of local content is specified in a number of industry-wide policies. A typical example is the automobile industry, which requires that the minimum rate of local content be 40 per cent.

However, under the TRIMs, those measures which are "mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage", and which "restrict the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports" are all considered to be "inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994" (MOFTEC 1995).

To analyse the various effects of China's local content policy, use is made of a partial equilibrium model of the automobile industry. In the following diagram, the

determines total components purchases of OA, of which OB are domestic purchase and BA are imports ($OB/OA=k$). In this situation, the rate of protection for components is $A'D/AA'$; the average cost of components to car producers is AC; and the effective rate of protection for automobile manufacturing industry is $(ST-A'C)/GS$. Thus with a local content scheme the domestic production of components is expanded, whereas the effective rate of protection for domestic car industry is reduced.

A local content scheme is thus a two-edged sword: it is one of the factors that determines the protection for not only the final goods but also the input (Corden 1971). In a domestic industry in which the final goods are protected by tariff or other administrative measures while the supply of input is relatively exposed to foreign competition, the introduction of local content scheme can help protect the input industry and increase the domestic supply of that input, although such a purpose is achieved at the cost of a diminished real protection for the final goods. In this regard, a local content scheme is very similar to an import tariff on inputs.

This conclusion has important implications for Chinese policy makers. The automobile industry has long been considered by the Chinese government as one of the pillar industries, the development of which is a national priority. In fact the central government has announced an extended development strategy and has injected a huge amount of capital into this industry. At the same time, an extraordinarily high protection rate has been reinforced to rule out the competition from foreign producers: the import tariff for foreign cars has been set at 80 per cent (Tariff Committee 1998) and the threshold for foreign investors is also extremely high so that most world auto-giants have been denied direct investment in the potentially big Chinese market.

If the policy makers attach more importance to the development of the automobile industry than the component industry, the current local content restriction should be relaxed, if not abandoned. This is because a local content scheme, like an import tariff on components, has the effect of offsetting the real protection for the final goods and hence discouraging domestic production of the final goods.

Under a local content scheme, changes of factors other than the local content ratio, k , will have effects on both the input and the output. If the demand curve for components, LL' , shifts to the right as a result of improved technology in the automobile industry, the price of domestic components and hence the average cost of components will rise and this will lead to a decrease in the effective protection for domestic cars and an increase in the effective protection for domestic components. If, instead, the supply curve of domestic components producers, EE' , shifts to the right as a result of technical progress in the domestic input industry, $N'Q$ will also shift to the right. Therefore, the average cost of components ($A'C$) falls, the effective protection for input declines and for output rises. Apart from the changes of domestic demand and supply of components, changes in the world price of components will also affect the real protection rate of components and cars: a fall in the world price OG , for example, will increase protection for components and cut down protection for cars.

The implication of this analysis for policy makers is that a local content scheme is not sufficient to compute the effective protection rates for both the input and the output industries as they are subject to changes in other variables, such as demand, supply and world price, which consequently bring about fluctuations in the effective

protection rates. In this respect, a fixed tariff on input is more transparent and stable. However, a local content scheme is more effective in protecting the domestic component industry in that it generates a domestic producers price, OP, which is higher than the price faced by domestic consumers, OX. To prove this proposition, suppose that an input tariff is imposed so that the average cost of components for component buyers is the same as under the local content scheme. Thus such an input tariff should be equal to A'C. It can be observed that with an import tariff A'C, domestic production of component is OB'', less than the production under a local content scheme. In terms of economic efficiency, the welfare loss rendered by a local content scheme can be measured by subtracting the producer's gain, PGE''Q', from the consumer's loss, XGZC. With an import tariff on components equal to GX, the welfare loss is given by two triangles YE''R plus CA'Z. Since the two shaded rectangles are equal, it can be deduced that $XGZC - PGE''Q' > YE''R + CA'Z$. Therefore, with the same average cost of components for domestic car producers, a local content scheme is more effective in protecting domestic component industry, but the cost is a greater social welfare loss.

Like other measures of protection, a local content scheme distorts free trade. Although it is more effective in the protection of domestic input industry than an input tariff, it imposes greater social welfare losses and hence severer waste of domestic resources. Furthermore, as a local content scheme serves as an indirect tariff on imports, or a non-tariff barrier, it is less transparent and less predictable.

Export ratio rules

Domestic laws and regulations which "restrict the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production" is also considered as being "inconsistent with the obligation of general elimination of quantitative restrictions" according to TRIMs provision (MOFTEC 1995).

China does not comply with TRIMs on this ground. Although the Chinese government has not fixed a particular export ratio for FIEs, it encourages them to sell their products on the world market. The *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures* rules that "an equity joint venture is encouraged to market its products outside China". Normally, an FIE cannot get ratification of establishment unless there are stipulated in its contract or article of association clauses ensuring a certain export ratio of its products. FIEs that export more than 70 per cent of their products are nominated as "enterprises of export orientation" and given preferential treatment (Chu 1987). Obviously, as a policy instrument, the exportation ratio rule is intended to generate foreign exchange to improve China's balance of payments. Before China relaxed controls on the current account, product exportation was an indispensable way for FIEs to keep their balance of foreign exchange receipt and expenditure.

This mandatory exportation is a distortion to trade which causes economic welfare losses. It artificially suppresses domestic supply and raises domestic price by

forcing FIEs to sell abroad at a world price much lower than the tariff-included domestic price. According to Pomfret (1994), large FIEs engaged in production of automobiles, elevators, glass or telecommunication equipment have found export goals to be unattainable, because China does not have a comparative advantage in these capital intensive products. On the other hand, a fairly large number of foreign investment projects in China are motivated, above all, by the huge domestic market that constitutes 22 per cent of the world's population. The compulsory exportation rule has inevitably driven away some potential investors.

Balancing foreign exchange receipts and expenditures

The Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures rules that "a contractual joint venture shall keep balance between its foreign exchange income and expenses" and *the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises* rules that "wholly foreign-owned enterprises shall reach by themselves the balance of foreign exchange receipts and disbursements". These provisions do not comply with TRIMs, which specifies that any domestic rules that "restrict the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise" are inconsistent with obligations provided in GATT 1994 (MOFTEC 1995).

At the time when the above laws were enacted, foreign exchange balance was a major concern of the Chinese Government. As Chen (1997) concludes, there were several reasons for the government to adopt the policy. First, it relieved the pressure on the government target to maintain a desired level of foreign exchange reserve. Second, by encouraging FIEs to export their products, it could further help improve China's overall trade balance. Third, it could promote localisation of joint ventures so as to speed up the transfer of technology and upgrade China's manufacturing capabilities.

The negative effects of these rules were evident: projects involving infrastructure and services of which sales were made completely in RMB were made less attractive to foreign entrepreneurs once the additional risk of RMB conversion was taken into account. This might be partly attributed to the disproportionately insignificant ratio of infrastructure projects to the total number of foreign invested projects, although the Chinese government offered extra tax holidays to infrastructure investment. However, the stipulation on foreign exchange balance seemed to be less demanding after the government introduced a number of alternative approaches through which FIEs could achieve their balance of foreign exchange payment: reinvestment of RMB (Chinese currency) profits, mortgage RMB on foreign exchange, foreign exchange swap market, etc.

Today, the provision of balance of receipt and expenditure in foreign currency is virtually invalidated due to the fact that free convertibility of RMB is already achieved under the current account and the FIEs can purchase and sell foreign exchange under current account in state designated banks with no restrictions.

Conclusion

China has successfully absorbed foreign investment since 1979. One of the most important contributions to this success is that China has significantly liberalised her domestic market which used to be almost inaccessible to foreign investors. In the past nine years during which China has been seeking accession to the WTO, the Chinese government has further removed restrictions on inward foreign investment and adjusted her policies in compliance with WTO principles. However, distortions still remain. In the light of the TRIMs agreement, which imposes restraints on government regulations to ensure that private investment decisions are not distorted by the maintenance of investment measures (Anderson 1996), this paper has focused on three major restrictions in China's foreign investment policies which are inconsistent with TRIMs, and discussed the purposes of these rules in their original context and the economic inefficiency associated with these rulings. To accelerate China's accession to the WTO and further liberalise her foreign investment regime, there is still much to be done to eliminate numerous kinds of administrative distortions. At present, it is imperative to incorporate the specific provisions of TRIMs in China's investment policies. This would bring a greater degree of predicability and transparency into China's investment environment and would be beneficial to both the foreign investors and the recipient county, China.

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China and the WTO's government procurement agreement

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Government procurement, which typically accounts for 10-15 per cent of world GDP (DFAT 1997, p. 7), has a significant impact on international trade. The Agreement on Government Procurement (AGP), a successor to the 1979 Tokyo Round Code on Government Procurement which entered into force on 1 January 1996, targets the openness of government procurement to international competition so as to contribute to the liberalisation and expansion of world trade by eliminating discrimination against, and among, foreign products, services and suppliers, and by enhancing transparency of laws and practices.

This paper discusses three main features of the AGP, as well as their implications for the AGP's multilateralisation, and analyses the potential benefits and problems with regard to China's accession to the Agreement. No conclusion is drawn on whether China should accede to the AGP or not because further research is needed.

Features of the AGP

Non-discrimination, transparency and leeway for developing countries are three basic principles of the AGP.

Non-discrimination

The principle of non-discrimination, which is composed of the two elements of national treatment and most-favour-nation treatment, is regarded as the main focus of the AGP. This is because government purchasing is usually used to provide industry development assistance. Article III states that the parties concerned shall not discriminate in favour of domestic products, services and suppliers against other signatory parties and between products, services and suppliers of the third party signatory origin.

However, the application of the non-discrimination principles in the AGP is conditional and limited because of a widespread use of specific country exclusions on the basis of bilateral reciprocity conditions. The signatory rights of non-discrimination may vary according to a contract or sector (Anderson 1996, p. 132). Exceptions on the basic obligations of non-discrimination is a crucial loophole in the AGP because non-discrimination is one of the cornerstones in the multilateral trade system.

Transparency

Transparency under Article IX is an other important feature of the AGP. Detailed rules regarding the tendering procedures are contained in the AGP. Tendering should be open or selective and competitive, either being open to all firms, or open to all pre-qualified firms. If qualification is a pre-condition, the AGP establishes detailed procedures and modalities to allow all firms that satisfy the technical criteria to qualify. Article VI concerns technical specifications used in invitation to bid, publication requirements, time limits and the content of tender documentation provided to potential suppliers. Article XIII states the rules for the awarding of contracts to the tenderer whose tender is determined to be either the lowest tender or the most advantageous in terms of specific evaluation criteria.

There is no doubt that there are still loopholes in the rules of transparency. For example, there are some terms, such as “the most advantageous tender”, which is based on specific evaluation criteria that are not defined in the AGP. More generally, the combination of positive and negative list approach for the coverage of entities, goods and services, varying thresholds, and the exemptions all undermine the principle of transparency, making it difficult to identify the effective coverage.

Leeway for developing countries

Article V of the AGP states special and differential treatment for developing countries through the process of negotiating terms of accession and variations of terms. To ensure that developing countries adhere to the principles of AGP even where they are perceived to be inconsistent with their development, financial and trade needs, such countries are allowed to negotiate with other members for mutually acceptable exclusions from the rules on national treatment with respect to certain entities, products or services that are included in its coverage lists.

These leeways, especially the use of offsets, are considered essential for developing countries seeking to accede to the AGP because the special terms in respect of the national treatment are in some respects necessary for their developmental, financial and trade needs. However, as the special and differential treatment is closely related to the negotiation process, the result is dependent on the strength and power of the joining developing countries in their negotiations with WTO members.

Generally speaking, the AGP plays an important role in the government procurement. However, there is still a long way to go before it is multilateralised in the WTO system. Moreover, the different development levels of the WTO members, the weakness of the AGP, in particular the conditional non-discrimination, are essential obstacles to its multilateralisation. To multilateralise the AGP, the coverage, membership and transparency needs to be increased. However, without fundamental changes in the pervasive application of reciprocity, the AGP’s effects on trade liberalisation are still limited because reciprocity highlights the asymmetry of economic power between nations and complicates the negotiations among members (Walker 1996). With regard to the developing economies, the special and preferential treatment in the AGP makes it easier for them to accede to the Agreement before they complete their transitional period of membership. However, whether or not they could join depends on the perceived implications for the economy in question.

Implications for China if it were to accede to the AGP

Since the economic reforms began in the late 1970s, the Chinese economy has achieved more than a 9 per cent average annual growth rate. To maintain such a growth, China has to overcome shortages of power and deficiencies in infrastructure. The Chinese government is expected to spend over \$1 trillion by the year of 2000 on infrastructure improvements, including power plants, highways, and telecommunication projects. In addition, the government also plans to invest in technology, equipment, and services for the modernisation of key industries and state enterprises (Dodds 1995). This ensures China's government procurement is attractive to foreign suppliers due to its lucrative opportunities. Although China has purchased a large quantity of foreign equipment and services, a significant portion of Chinese government procurement is still closed to foreign companies (Dodds 1995). In the process of negotiation China's accession to WTO, China faces pressures from major WTO members to sign the Agreement.

Potential benefits to China from acceding to the AGP

There are substantial potential benefits to China from signing the Agreement. Chinese producers not only will be provided with access to other signatories' markets, but also will be subjected to increased competition and transparency in its government procurement practices.

Access to signatories' government procurement markets. By signing the Agreement, China could have access to the government procurement markets of the other signatories to the AGP. GATT data shows that the aggregate amount of purchases by signatory countries to the earlier Tokyo Round code on government procurement was estimated to be around \$US62 billion in 1992 (PC 1996). The coverage of the new Agreement encompasses a much larger proportion of procurement than the Code it superseded. According to the Productivity Commission's estimation, government procurement covered by the AGP is in the vicinity of A\$500 billion to A\$800 billion per year (PC 1996). Accession to the AGP therefore will provide many opportunities for Chinese companies and give Chinese exporters guaranteed access to the potential markets of other signatories.

Foster competition. The AGP mechanism aims at fostering more-effective competition. With more competition, the government would be able to procure better quality goods and services at a lower price. This will effectively reduce government procurement costs and ease the government's budget constraint. Enhancing competition through joining the AGP is especially significant because of the on-going reform of State-owned Enterprises (SOEs). The AGP competitive mechanism would make the SOEs more profit-oriented. The reduction of production costs and improvements in quality will increase the competitiveness of SOEs both in domestic and international procurement markets.

Increase transparency and reduce corruption. To sign the AGP, China has to improve its current procurement system alongside the development of a more open, competitive and transparent system. This will help reduce corruption in government procurement and will allow greater trading opportunities between China and the rest

of the world. At the same time, since transparent procedures are already documented by signatories, accession to the Agreement would provide China with guaranteed certainty, transparency and commonality in the process of selling to foreign government agencies.

Potential problems for China's accession to AGP

While there are quite substantial benefits for China to join the Agreement, there are also some potential problems for China's accession to AGP.

Potential impacts on China's industry development. The AGP places limitations on the ability of governments to use their purchasing power to achieve industrial development objectives through the use of offsets. Article XVI of the Agreement prohibits entities from imposing, seeking or considering 'offsets' in the qualification and selection of suppliers, products or services, or in the evaluation of tenders and award of contracts in government procurement. The Agreement broadly defines offsets as 'measures used to encourage local development or improve the balance of payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements' (WTO 1994). The non-discrimination principles of the AGP, and in particular this prohibition on offsets, may have significant implications for Chinese government procurement policies. For example, at present China is still using offsets such as local content, technology transfer, and co-production requirements as a leverage to promote economic development and to deal with the problems of lack of competition and asymmetric information. To join the AGP, China's use of offsets would have to be reduced and this could dampen China's industrial development, reducing (perhaps non-economic) benefits from such development which needs to be weighed against the costs of resource misallocation and the increased costs of goods and services procured by the government under current arrangements.

Potential impacts on China's international trade and employment. By choosing between purchasing overseas and favouring domestic suppliers, governments can have a marked impact on international trade patterns (McAfee and McMillan 1989). Membership of the Agreement could lead to an increase in direct foreign offers because, since China's open door policy began, many foreign suppliers have entered the Chinese market and established fairly good distribution networks and after-sales services. This could influence the market shares of domestic suppliers. With China's government procurement expected to exceed one trillion US dollars by the year 2000 (Dodds 1995), the impact on China's trade balance could be substantial.

At present, unemployment has become an increasing concern for China, especially those laid-off workers from SOEs. China's accession to the AGP could add to the severity of unemployment in the short run, as some SOEs are particularly reliant on government orders. Their failure to win contracts means that unemployment in an already depressed industry would rise.

Access to other signatories' markets. In relation to theoretical benefits from access to other signatories' markets, if we take into account the fact that AGP members are overwhelmingly drawn from industrialised countries, and that at present China has few firms, goods and services that can compete in AGP members' government procurement markets, significant access to their markets might prove

difficult in practice. The potential export benefits for China from membership could be limited, therefore.

Political economy and other considerations. Given the weakness of the AGP and the potential impacts mentioned above, China would need to exercise caution in considering accession to the Agreement. By reducing and eliminating the use of offsets due to accession, China would lose the leverage of using the attractiveness of China's vast market potential to urge foreign firms to invest in China's priority projects and transfer technology, or enter into co-production arrangements.

The AGP's special provisions for developing countries mean that if China signs the Agreement, it may not have to open all of its procurement and it can still require offsets in certain instances. However, since some WTO members have been reluctant to support developing country status for China's accession to WTO, China may meet some difficulties in negotiating developing country offset-use provisions, if it seeks accession to the AGP. Without special considerations, China would be less likely to sign the Agreement. Nevertheless, it is certainly in the AGP signatories' interests to allow some leeway for the gradual reduction of China's use of offsets, in order to have her sign up and thereby make Chinese government procurement markets more transparent and predictable. On the other hand, we have to bear in mind that China's accession to AGP will be two-edged. Since there are only 23 signatories by now, those non-members would probably not want China to sign the AGP because Chinese membership would mean a closed Chinese government procurement market to them.

As Dodds (1995) pointed out, China's socialist market economy and huge decentralized procurement system pose a number of problems for its accession to the Agreement. The concept of what constitutes government procurement in China is still obscure. For China to sign the Agreement, it has to be decided whether Chinese SOEs, which constitute a large part of the economy, should be subject to the Agreement or to other GATT provisions on tariff and non-tariff barriers. In addition, China needs to decide the minimum SDR thresholds. Another problem to be addressed is China's lack of a comprehensive government procurement law. Although China is now drafting the Tendering and Bidding Law, it takes time to perfect legislation of this sort. Furthermore, bringing China's procurement system into conformity with the AGP's procedural and reporting requirements would be very challenging and costly for China at this moment because of China's backwardness in statistics collection and its lack of professionals in the management of government procurement.

Conclusion

The government procurement market is too big to be left beyond the reach of the multilateral trading system, and there are strong pressures from export competitive countries to improve their access to this market. Under the wave of deregulation and corporatization of government enterprises since the 1980s, the size of government sector has been reduced. This might provide more possibilities for the AGP's multilateralisation. China is facing increasing pressures to accede to the AGP. As the AGP is only a plurilateral agreement at present, China has no obligation to join it in the process of China's accession to WTO. In terms of the implications for China to accede to the AGP, there are potential benefits, but the negative impacts and other

problems should also be considered, taking a long-term view. Whether China accedes to the AGP or not, the government procurement regime is important and a worthy part of China's economic reform program.

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Implications of WTO accession for China's grain self-sufficiency

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With the signing of the Uruguay Round Agreement on Agriculture (URAA) in 1994, agriculture for the first time was brought into the mainstream of the multilateral trading system. Given its commitment to the accession of WTO, China must face the short and long term impacts of the URAA. This paper first examines China's WTO accession issues in the agricultural sector. Then, assuming China joins the WTO, it studies the short and long term impacts the URAA may have on China's grain self sufficiency. It argues that, with inevitably decreasing comparative advantage in grain production, under the rules-based WTO it would be both costly and impractical to pursue full grain self sufficiency. On the other hand, by dismantling impediments to the increase of China's grain productivity and providing appropriate policy institutions and incentives, China could offset the declining trend in grain self-sufficiency without necessarily sacrificing overall economic growth.

URAA and China's accession to WTO

The URAA basically has three main components: reducing farm export subsidies, converting non-tariff barriers (NTBs) to bound tariffs and reducing the tariffs to increase market access, and cutting domestic producer subsidies (Anderson 1997). The prohibition of NTBs excludes sanitary and phytosanitary import measures which are scientifically based.

The members of the WTO naturally wish to see China subjected to discipline in all these three areas. In China, state subsidies on grain imports were abolished in April 1991, and grain trading companies were made responsible for their own profits and losses (Cheng 1995). According to our understanding, domestic producer subsidies are also not prevalent in China. What really matters at present is the market access issue. According to the URAA, where the domestic selling price exceeds the border price because of import restrictions, a tariff quota is permitted. Based on this rule, China would allow the import of grain at a zero or low duty up to a certain volume, and then would charge a much higher tariff on over-quota imports. Members of the WTO complain that the offered in-quota quota is not enough to match their present sales volumes and their expectations about future sales volumes. They are also not satisfied with China's desire to bind its over-quota tariff at a very high level (Anderson 1997). Therefore, they argue for binding the tariffs nearer to current applied rates and reducing them over the transition period, and for an increase in the offered in-quota volumes.

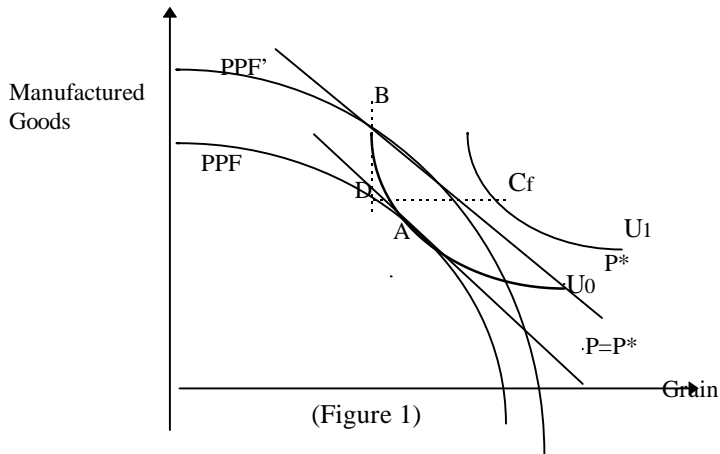
Given China's present economic development stage and still unfinished reform process in the grain sector, meeting all the above requirements in order to become a member of WTO will not be easy politically, but that is not the topic of this paper. Having committed itself to accession to WTO, eventually China will need to bind its tariffs at lower levels and reduce them over time.

Short- and long-term impacts of the URAA on China's grain self sufficiency

As the Chinese economy becomes increasingly integrated with the world economy, so does China's grain trade. For the period from the early 1980s to the early 1990s, China's share of world wheat imports was maintained at about 15 per cent and its share of world maize exports rose from a negligible level to more than 10 per cent (Cheng and Findlay 1995). Less than 1 per cent of China's rice production is exported though (Anderson and Peng 1998). China has already been a net grain importer and, currently, China's grain self sufficiency rate is about 95 per cent (Anderson et al. 1997). In the remainder of the 1990s, China will likely maintain its self sufficiency in rice, remain a net importer of wheat, and see an increase in maize imports (Findlay et al. 1993).

Contrary to many peoples' concern about China's grain self sufficiency following WTO accession, in the short term China's grain self sufficiency rate may be helped or at least maintained by accession. Anderson et al. (1997) use a standard global computable general equilibrium model know as GTAP and project that after China's accession to the WTO, with an annual GDP per capita growth rate of 7.8 per cent, China's grain self sufficiency will actually increase slightly, from the current 95 to 96 per cent by 2005. If economic growth slows down, the grain self sufficiency rate will be even higher (ibid). Based on this scenario, we expect that if an economic growth rate of 8 per cent targeted by the Chinese government is maintained annually, China's grain self sufficiency rate will only be slightly lower than 95 per cent by 2005. International prices of agricultural products are not expected to change highly relative to manufactured goods prices. Therefore, the accession to WTO will not lead China to suffer grain self sufficiency problems in the short run. The reasons behind this conclusion are straightforward. After China's accession, the reduction of protection in heavy industry will cause more resources to be released to (or less drawn from) the agricultural sector. As well, people will have more choices to change to cheaper substitutes for grains. Therefore, China's grain self sufficiency could be maintained.

But in the long run, even without WTO accession, along with China's continuous industrialisation process and the ever-growing population pressure, China will more and more reveal its comparative disadvantages in grain production, leading to an eventual reduction in its grain self sufficiency. This can be illustrated in Figure 1.



In Figure 1, grain is on the horizontal axis, manufactured goods are on the vertical axis, and the production possibility frontier is shown as PPF. Assuming that there are no distortions, then if China happened to exactly achieve full grain self sufficiency at point A, then the domestic price ratio P equals the world price ratio P^* . In this case, there is no need for grain trade, and China obtains a utility level U_0 . In the long run, as the industrialisation process continues, more resources are attracted from the agricultural sector to the manufacturing sector, so the PPF will experience an outward shift which is biased toward the vertical axis, resulting in a relatively larger output of manufactured goods and a relatively smaller grain output. The grain self-sufficiency rate goes down, and there is the necessity to export manufactured goods and import grain to compensate for the short grain supply. As shown in Figure 1, even if the world price ratio P^* remains unchanged, China needs to export BD units of manufactured goods and import DC_f units of grain to clear the market. But by doing this, China's national welfare increased from U_0 to U_1 .

China used to be 100 per cent grain self sufficient with a low level of industrialisation. The current 95 per cent grain self sufficiency rate is the result of the industrialisation process. According to Lin (1998), from 1952 to the 1990s, the share of agriculture in the national economy has declined from 58 per cent to less than 25 per cent. This trend has been especially obvious since China adopted reform and an opening up policy in 1978. In the GTAP model, Anderson et al. also project that in the coming decade, massive structural change in China will continue and the share of farm and food activity in GDP is to further decline. Both findings are also in line with the production and trade patterns of the earlier industrialised, heavily-populated economies of Japan, Korea and Taiwan. Notwithstanding their high agricultural protection, these densely-populated economies have become increasingly dependent on imported farm products as their agricultural comparative advantage has decreased (Anderson and Peng 1998). All these demonstrate the following facts: even without accession to WTO, China's comparative advantage in grain production is destined to decline over time and its grain self sufficiency rate will be reduced, due to the endogenous needs of China's industrialisation and economic growth and the increasing population pressure.

Given the above, the URAA has long-term implications for China's grain production sector. Facing declining grain production per capita in the long run, one plausible response would be to increase tariffs and NTBs, and/or provide producer subsidies in order to boost domestic grain production. But being a member of the

rules-based WTO, the possibility to resort to such protective measures for grain self sufficiency is excluded. This accession impact is actually good for China's economy, as protection and maintenance of grain self sufficiency without slowing industrial development and economic growth is simply not going to be possible (Anderson and Peng 1998). Protective measures will create artificial price signals and attract resources away from the export industries based on true comparative advantages, which generates economic welfare losses and high production costs for China.

This possibility that China will be a massive net grain importer in the long run has created great concern amongst China's policy makers concerned with food security. Two important positive factors can help to ease the worry. First, WTO provides a more stable and more predictable multilateral trading system which provides contributes to market security for a more grain import-dependent China. Second, a higher economic growth rate will make China better able to pay for its grain imports.

But China can do much better than this. By dismantling impediments to the increase of grain productivity and providing policy institutions and incentives to further achieve this, China will be able to offset the declining trend of grain production both in the absolute and the relative sense. Based on this proposition, we propose the following suggestions.

Some realistic ways to boost grain productivity and help grain self-sufficiency

Reduce government intervention in grain production and marketing, and improve markets for factors of production

Policy uncertainty is a major problem plaguing China's grain production. It frustrates farmers and makes them less willing to invest long term in land. This is the first impediment to the increase of China's grain productivity and is due to excessive government intervention. For example, China's commercial grain base area programme identifies regions with comparative advantages in grain production with the aim to increase their productivity. But the unstable state purchasing prices frustrate the initiative of farmers to grow grain and to invest in land, which results unsatisfactory implementation of the programme (Yang 1998). The Provincial Government Responsibility System in fact encourages surplus production provinces to control the outflow of grain, distorting market prices of grain in different provinces and making the real market demand more difficult to predict. The government's involvement in grain marketing also suppresses the role of the market. That excessive intervention hampers regional specialisation and optimal resources allocation. To better explore the comparative advantages of different regions and to concentrate efforts in the best grain production regions, further market oriented reforms are needed. China needs to foster a national grain market and create markets of factors of production, limit the role of the government in grain marketing to purchasing the buffer stock and using international trade to keep the market mechanism healthy. By letting farmers respond to real market signals, the market-oriented reforms will not only help the better utilisation of comparative advantages of different regions, but also will help reveal the real market value of grain, thus increasing certainty and predicability.

Increase investment in agriculture infrastructure and scientific research

Lack of investment in agricultural infrastructure and scientific research poses another impediment for China's grain productivity increase. China needs to direct more investment into comprehensive agricultural infrastructure projects. A sound infrastructure is a prerequisite for increasing productivity and stabilising grain production. It will not only help increase productivity by way of improving soil and irrigation, but also help to improve ecological environments by preventing flood, drought and other natural disasters, enabling peasants to lower their production costs.

Increasing investment in scientific research with the aim of increasing unit yield is another key to raising grain marginal productivity. Studies have found that there is a strong link between investments in agricultural research and rapid agricultural productivity growth, with such research being positively correlated with high economic returns (Anderson et al. 1997). According to Lin (1998), the unit yield of China's rice is 2.57 times less than the experimental unit yield, and the unit yields of wheat and maize are only 43 per cent and 26 per cent of the world's maximum unit yield, respectively. This indicates that there is a great deal of potential for China's grain productivity growth if sufficient funds are allocated to engage in the necessary scientific research.

Design policies and institutions for long term grain productivity increase

China not only needs to reduce non market-oriented government interventions in the grain sector, but it also needs to provide the right policy incentives for long term grain productivity increases. Currently, the land lease tenure has been lengthened to 30 years (Jiang 1998), which has provided more certainty to farmers. But this is not enough. Modernised agriculture may require larger-scale farming and a higher level cooperative farming organisations such as cooperative share-holding farming enterprises to go along with it. Larger-scale farming and complementary farming organisations will help to make a substantial substitution of capital for labour, facilitate the extensive use of farm machinery, and encourage effective specialisation. This is vital for a dramatic increase of grain productivity per capita. But both involves well-defined and long term land use rights which can be inheritable and alienable. The government should try to develop a set of policy institutions and mechanisms to facilitate this evolutionary trend and other productivity increasing aspects to achieve its goal.

Conclusion

China used to have full grain self sufficiency with low levels of economic development and national economic welfare. But China is destined to shift its comparative advantage from agriculture to other sectors along with its rapid industrialisation and economic growth. With agriculture brought under multilateral trade discipline, accession to the rule-based WTO will, in the short run, help maintain China's grain self sufficiency, but in the long run, excludes the possibility for China to resort to protective measures to increase grain production. This does not mean that China can only passively accept the fact. On the contrary, by dismantling the

impediments to an increase in grain production and by the design of appropriate policy incentives, China may be able to greatly boost its grain productivity. This can offset the declining trend in its grain production to a certain extent and help maintain grain self sufficiency. And by doing so, China's economic growth and national welfare will suffer little by way of sacrifice and may even be enhanced.

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Labour standards, WTO, and China

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The entwining of trade policy with labour standards is a highly controversial issue in the world trade organisation (WTO). After the Uruguay Round, it was raised as plausible agenda for future multilateral trade negotiations. Although the Singapore Ministerial Declaration in 1996 said that the International Labour Organisation (ILO) is the competent body to set and deal with internationally recognised core labour standards, it did not deny that there was no work on the subject for the WTO. Instead it noted that the WTO and ILO would continue their collaboration. This leaves enough room for continuing the debate.

This paper begins with an economic analysis of the labour standards issue, then discusses whether the WTO or ILO is the proper forum to address the issue, and finally examines some implications for China and draws some brief conclusions.

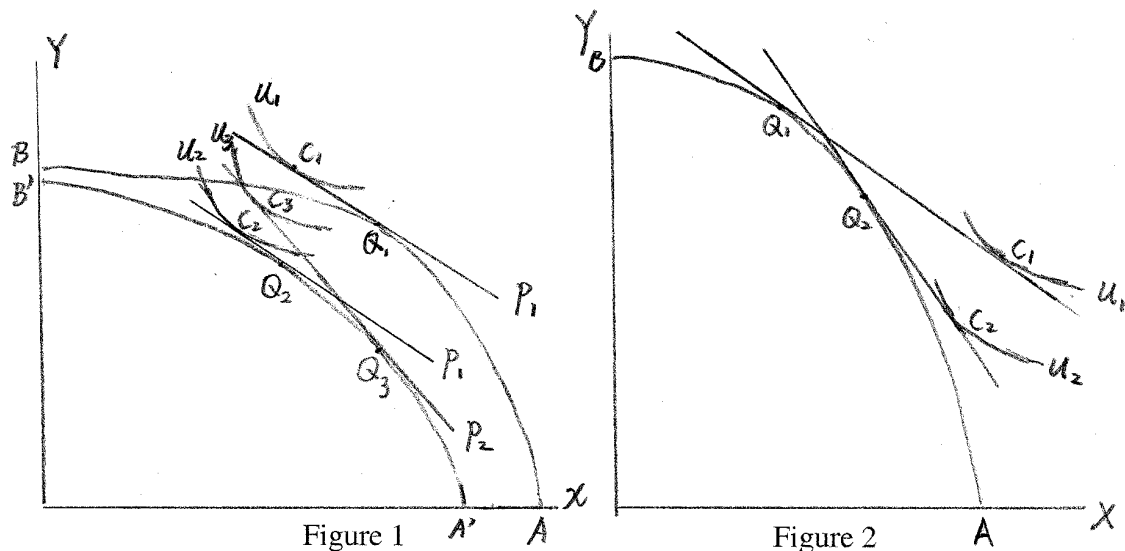
Economic analysis

The linking of labour standards with trade policy is not a new issue. In the 1960s, protectionists pleaded for international minimum wage legislation to prevent some countries from gaining comparative advantages through low wage cost. In 1984, the Generalised System of Preferences was amended to require countries meet a new labour standards to retain their eligibility. And as early as 1986 the United States raised the question of “workers’ rights” to the GATT.

In the past twenty years, there has been a rapid spread of export-oriented industrialization to a growing number of developing countries. The expansion of the supply of labour-intensive goods depressed their relative price and hence reduced the demand for labour and capital in unskilled labour-intensive industries in rich countries, resulting in high unemployment and/or a growing wage differential between skilled and unskilled labour. Relatively low labour standards were given as one of the main reasons for low production costs, which were said to cause “unfair trade”. Historical evidence shows that rising inequality in rich countries induced by globalization was responsible, at least in part, for the interwar retreat from globalization (Williamson 1997). In the 1990s, the GATT and WTO successfully eradicated many traditional trade barriers and under the constraint of the new dispute settlement mechanism in the WTO, it is difficult for one country to take unilateral action, so labour standards can be an important bargain chip for rich countries.

Traditional trade theory assumes that all labour to be homogeneous, but rich

countries invest more in education and training and have more high-skilled labour while poor countries are relatively abundant in low-skilled labour. So in the following modified model, X is a low-skilled labour intensive industry (labour here means low-skilled labour), and Y is capital and high-skilled labour intensive. Initially, we assume there are no labour standards in large country A which is labour abundant, whereas in capital abundant country B (the rest of the world) there are high labour standards in place already.



It is assumed that labour standards are relatively labour-consuming. Hence when they are imposed in country A the production possibility frontier (PPF) for producing X and Y shrinks. In figure 1, for country A, labour standards will reduce the production of X more than Y, the PPF shrinks from AB to A'B'. If the price ratio did not change, welfare would decrease from U_1 to U_2 . However, because the supply of X is reduced more than Y (the Rybczynski effect would suggest X production could even shrink), the price ratio (P_x/P_y) will improve from P_1 to P_2 , and production and consumption will be at Q_3 and C_3 , respectively. In that case U_3 is higher than U_2 , but could be still lower than U_1 . That is, the PPF shrink effect on welfare is from U_1 to U_2 , and the terms of trade improvement effect is from U_2 to U_3 .

For country B (rich countries making up the rest of the world), this imposition of higher standards in poor countries has the effect of a deterioration in its terms of trade. In figure 2 this is shown to increase the production of X and reduce that of Y. Production and consumption move from Q_1 and C_1 to Q_2 and C_2 , respectively. Welfare drops from U_1 to U_2 . However, not all groups in rich countries lose. On the contrary, according to the Stolper-Samuelson theorem, a relative increase in the price of less-skilled labour intensive goods will increase the real return to the less-skilled labour in rich countries. That is the reason why their labour unions and related interest groups advocate higher labour standards in developing countries.

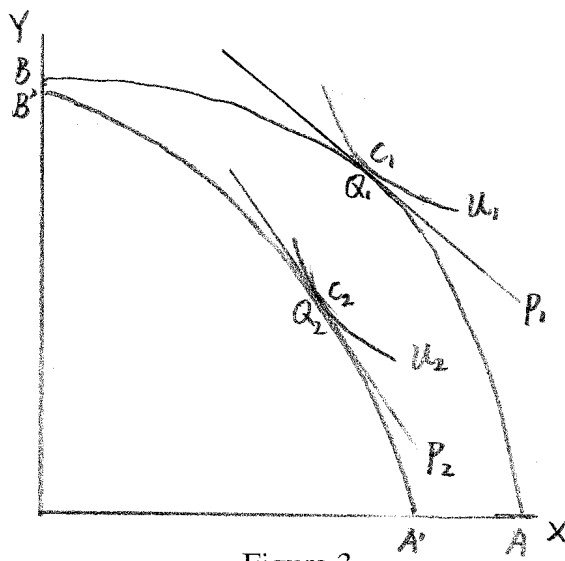


Figure 3

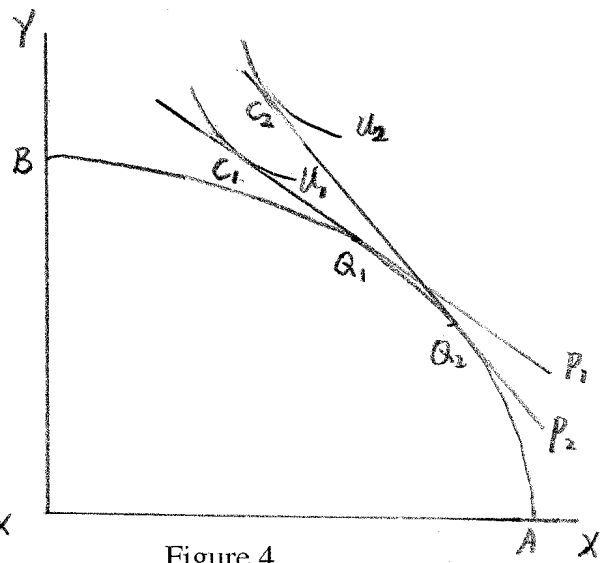


Figure 4

In figure 3, the raising of labour standards causes the world PPF to shrink inward from AB to A'B' and the price ratio increases from P_1 to P_2 , so that world welfare decreases from U_1 to U_2 . Because the labour standards are different in developing countries, the introduction of minimum labour standards will improve the welfare of those labour-intensive countries which have relatively high labour standards. In figure 4, the PPF of these countries will therefore not shrink, so the improvement of their terms of trade will increase their welfare, from U_1 to U_2 . This explains why some developing countries support the advocacy of labour standards in the WTO.

Furthermore, Bhagwati (1994) argued that labour standards cannot be easily shaped by policies. Instead, they are not international public goods but market outcomes that will be influenced mainly by income growth. Each country determines its own rules and regulations, including its labour-market regulations, according to its specific institutional and historical set-up, level of economic development, etc. Only the principles are internationally recognised, not the setting of the level of standards which necessarily are country-specific.

There are two approaches to raising labour standards (OECD 1996). The Push approach is where governments often take direct action to raise labour standards: directly raising wages by means of government expenditure policy for the public sector and minimum wages for the private sector, encouraging and facilitating strong trade union, instituting ambitious labour codes, etc. The Pull approach is where labour standards are promoted indirectly, via actions to accelerate economic growth so that improvement in wage and employment opportunities can be afforded.

"Push" countries are mainly in Latin America, Africa and South Asia; by contrast, newly industrialised economies (Singapore, Hong Kong, Korea, and Taiwan) are noteworthy for their reliance on indirect methods, and the virtual absence of direct ones. In most successful manufactured exporters, the price of labour to the employer was kept close to a market-determined wage rate because of the lack of social security, trade union, minimum wage, and so forth. This reduced the benefit

accruing to workers at any point in time, but with rapid economic growth real wages increased in the 1970s. At the same time, economic growth stagnated in the “Push” countries.

It is certainly possible that raising labour standards may raise the welfare of labour. But the real net effect is more complicated. If there is market clearing, employers may raise working conditions but reduce the wage of labour. It could lead to welfare reductions for workers because different workers have different preferences and cash can provide more utility than specific labour standards. On the other hand, if there is wage rigidity, some labour with low marginal product will be forced out when standards are raised, in which case the welfare improvement for the employed is raised at the expense of the unemployed. Total output and aggregate welfare will be reduced.

Legal and institutional analysis

A comparison of the roles of the ILO and WTO indicate that the ILO rather than the WTO is the more appropriate place to explore the labour standards issue.

With respect to the ultimate end of the WTO and ILO, the two organisations share a common goal: to improve social welfare, including the raising of welfare of workers. However, they have their own specific roles in contributing to that common ideal. The WTO, as the only international body dealing with the rules of trade, takes responsibility for the multilateral trading system, and at its heart are the WTO agreements. The ILO, as a United Nations specialised agency, focuses specifically on the promotion of social justice and labour standards. Since its establishment in 1919, it has passed more than 180 Conventions setting up labour standards for virtually every labour issue, which cannot be matched by any other international or regional organisation.

Furthermore, the ILO is a unique body, in so far as it is a tripartite institution, bringing together the representatives of employers and employees and governments, for all of which it is feasible to participate on an equal basis in the working of its governing organs. On the contrary, labour unions have no direct voice in the WTO which was not designed and well suited to implement labour standards. This uniqueness of ILO provides workers a channel to give their voices and guarantees the effective protection of their rights and interests.

In terms of institutional aspects, the WTO is not able to take the responsibility to establish a universal agreement about labour standards, since there is no universal agreement. The ILO, in order to set a certain degree of harmonisation of conditions of labour, formulates international labour standards in the form of conventions and recommendations. Conventions are binding only for countries that have ratified them. Recommendations containing detailed standards are non-binding. In practice, the average number of ratification lies around 50 per country in Europe, while it is 25 in Africa and 17 in Asia (Edgren 1979). By 1995, the United States had ratified only 12 of the 175 international labour conventions (Leary 1996). All these facts suggest that labour standards need to be flexible rather than rigid. And the ILO has been conscious of the need to take account of different countries’ differences in social culture and economic development. On the other hand, under the WTO, all the provisions are compulsory and member countries have no choice except to accept them. Therefore, it

is difficult to introduce labour standards into the WTO agreements.

In addition, regarding the enforcement mechanisms, any violation of the WTO agreements may result in trade sanctions, which are not an effective means to improve labour standards. Although the ILO is empowered, under article 33 of its Constitution, to take such action as may be considered wise and expedient to secure compliance, in practice, the ILO relies on technical assistance, peer pressure and persuasion to encourage stricter compliance. It does not and cannot impose sanctions -- financial, economic, commercial, or others (Mah 1997). This is also the reason why the ILO, which in its original form envisaged the possibility of sanction for violation of labour standards, finally gave up that idea and only mentioned the possibility of "action deemed wise and expedient to secure compliance" in Article 33 (Leary 1996).

Implications for China

The issue of linking trade policy with labour standards has become sensitive to China due to the rapid growth of trade and its structure of traded goods. In 1977, the value of China's merchandise trade was just US\$15 billion (Pomfret 1996), while by 1997 it had increased dramatically to US\$325 billion with export of US\$142 billion (Shi 1998). Trade is very important for China's economy. In 1997, the ratio of exports plus imports to GDP was 36 per cent. With respect to the composition of trade, most of China's exports are low-skilled labour intensive manufactures. In the early 1990s, China has a substantial share of world exports of manufactured goods. The shares of export of manufactured goods in the total exports of China in 1980, 1985, 1990, and 1994 were 50, 49, 74 and 84 per cent, respectively (Pomfret 1996).

Therefore, as the debate on labour standards and trade negotiation becomes fiercer within the WTO, China is becoming more concerned about this issue, especially during its accession to the WTO. China prefers the pulling approach to the pushing one and argues that labour standards should be set up corresponding to each country's economic development.

However, China has no intention to deny the governments' role in improving labour standards. In fact, China has made great progress in this aspect. At present, China has ratified 17 ILO conventions and promulgated many laws and regulations in the field of labour. The Trade Union Law and the Labour Law are two good examples. The Trade Union Law of 1992 takes account of the significant achievements that China has made during previous decades. It ensures trade unions' position in China's political, economic and social life. Its main task is stipulated as safeguarding the legal rights and interests of staff members and workers and organising them to take part in democratic management and supervision of their enterprises. Although the law is different from some western trade union laws in the aspect of the independence of the union, wage bargaining and grievance handling, which is criticised by some western scholars (Levin, 1997), it nonetheless represents great progress as the trade unions' status and rights are now protected by law. The Labour Law of 1994 is another important law covering almost all aspects of labour affairs and labour standards. For instance, the law initially established the 44 working hours per week regime and later further reduced that to 40 with the improvement of labour productivity.

China has been doing its best to try to accede to the WTO and improve its

labour standards. For example, China ratified the International Covenant on Civil and Political Rights recently. However, if developed countries insist on entwining trade policy with labour standards and put pressure on China to adopt unaffordable labour standards, it will just delay China's accession to the WTO, which will be harmful to the world economy.

Conclusions

With political, economic and cultural differences among countries, it is inappropriate to set up worldwide binding labour standards. Imposing uniform labour standards on developing countries will only benefit some developing countries and low-skilled labour in developed countries, and could reduce global economic welfare. The improvement of labour standards can only be realised through sustainable economic development. The WTO can advocate the improvement of labour standards, but its main task is to increase each country's economic development by promoting international trade. For China, after its accession to the WTO, its trade will expand and act as an engine of economic growth. Correspondingly, its labour standards will be improved further.

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