

2000

Enter the Dragon: An Essay on China's WTO Accession Saga

Raj Bhala

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ENTER THE DRAGON: AN ESSAY ON CHINA'S WTO ACCESSION SAGA

RAJ BHALA *

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* Patricia Roberts Harris Research Professor of Law, The George Washington University Law School, 2000 H Street, N.W., Washington, D.C. 20052. Tel. 202-994-2266. Fax. 202-994-9446. A.B. (Economics), Duke University, 1984; M.Sc. (Economics), London School of Economics, 1985; M.Sc. (Management), Oxford University, 1986; J.D., Harvard University, 1989. Marshall Scholar, 1984-86.

I am grateful to Professor Jeffery Atik, Suffolk Law School, for inviting me to write this essay and present it at an American Society of International Law meeting in February 2000, and to Professor Jeffrey Dunoff, Temple Law School, for his support in publishing it.

I also am grateful to the following friends for the opportunities they provided to present earlier drafts of this essay: my GW colleagues, Professors Ralph Steinhart and Sean Murphy, at a GW adjunct faculty lunch on 22 March 2000; Professor Michael Vitiello, McGeorge Law School, at a McGeorge faculty lunch on 10 March 2000; participants at a Workshop on Lao Legal Reform in Vientiane, Laos on 15 March 2000 and at a World Bank lunch in Washington, DC on 25 May 2000; and participants at a G.W. L.L.M. alumni reunion lecture at Oxford University on 22 July 2000. I am thankful for the many helpful comments and suggestions I received in all of these venues.

As always, my cosmopolitan research assistants at GW did a first-class job helping me edit this essay: Mohammed Zakirul Hafez (Bangladesh); Kris Hansen (Iowa); Preeti Kapoor (Michigan); Khattar Torbey (Lebanon); and Christian Ulrich (Germany). Where would I be without them?

Finally, I cannot help but note this is the first piece written following the birth of my daughter, Shera. I am ever so pleased to dedicate the essay to her in the hope that she may one day experience the wonder, awe, and humility that I have in traveling through China.

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I. THE IMPORTANCE OF THE CHINA CASE STUDY

How did a country join the General Agreement on Tariffs & Trade (“GATT”)? How does a country become a member of the World Trade Organization (“WTO”)? GATT Articles XXXII-XXXIII and WTO Agreement Articles XI-XII provide the answers. To examine these provisions in the context of China’s bid to join or re-join, is entertaining and instructive. The story itself is an epic saga, and no country currently seeking WTO membership - Saudi Arabia, Iran, and Russia, for example - could possibly raise a more complex array of issues than the People’s Republic of China (“PRC”). Neither the principles nor policies, theories nor doctrines, laws nor regulations in the domain of international trade are irrelevant to the PRC epic.

Using the PRC case study as a vehicle for examining how countries join the WTO club does not imply that the PRC is a uniquely important applicants. Nor does it imply an endorsement of former United States Secretary of State James Baker’s statement in his April 7, 1999 *Financial Times* editorial that “[t]he United States has no

bilateral relationship today more important than that with China.” In a provocative article in the September/October 1999 issue of *Foreign Affairs*, Gerald Segal, the Director of Studies at the London-based International Institute for Strategic Studies, argues persuasively that the Middle Kingdom is a second-rank power that has mastered the art of diplomatic theater. China is worthy of no more attention than Brazil or India. Trotting out an array of statistics, Segal points out that the PRC’s real status in the global economy is far less important than western political and business officials believe. For example, in 1997 the PRC accounted for a measly 3.5 percent of world GNP (the United States was 25.6 percent), and its per capita GDP ranking was eighty-one (roughly \$773), making China fall behind Papua New Guinea. In 1997, the PRC made up just three percent of world trade - the same as Korea and less than Holland - and only eleven percent of total Asian trade. (Interestingly - before the Communist “liberation” of 1949—China’s importance as a trading power peaked in 1928, when it accounted for 2.3 percent of world trade. The PRC did not surpass this level until 1993. In 1977, on the eve of the transition away from a command economy, it accounted for just 0.6 percent.

The PRC currently ranks 107th on the United Nations Human Development Index, resting between Albania and Namibia. Likewise, the PRC’s military capabilities are, says Segal, vastly overstated and it has no fearsome allies. The PRC accounts for barely 4.5 percent of global defense spending, whereas the United States stands at 33.9 percent. Culturally, the PRC is a beacon for no one. India exerts a far greater cultural call on non-resident Indians than does China on overseas Chinese, who are influenced far more by films, music, literature, and the arts from Hong Kong, Taiwan, and even Singapore.

Segal, however, may have forgotten about the resilience and entrepreneurial zeal of the Chinese people, and about the vast and unique potential of the Chinese nation. Whatever the merits of his argument, the point of the PRC case study is that it embodies all of the issues that could possibly arise in accession—the the proverbial “worst case” scenario. The multilateral trading system will never again witness such an accession saga.

A. THE ACCESSION PROCESS

Article XXVI of GATT contains provisions governing the entry

into force of the agreement. As specified in Article XXXII, the “contracting parties” are those countries that are original (*i.e.*, founding) parties of GATT or that subsequently acceded to GATT. Article XXVI is relevant to the original contracting parties, whereas Article XXXIII establishes the process of accession for countries that are not founding members. The twenty-three original contracting parties are:

Australia, Belgium, Brazil, Burma (Myanmar), Canada, Ceylon (Sri Lanka), Chile, China, Cuba, Czechoslovakia, France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, Southern Rhodesia (Zimbabwe), Syria, South Africa, United Kingdom, and the United States.

Article XXX:1 of GATT states that amending GATT requires either a two-thirds or unanimous vote of the CONTRACTING PARTIES, depending on the provision being amended. Article XXXIII requires a two-third majority to amend a provision. Article XII of the WTO Agreement is little more than an echo of the GATT Article XXXIII, which is minimalist in content. Article XXXIII allows governments that are not a party to the GATT (or a government acting on behalf of a separate customs territory that possesses full autonomy in its external commercial relations) to accede to the GATT. This can only occur based on terms agreed to between the applicant government and the CONTRACTING PARTIES. Then, the CONTRACTING PARTIES must approve a decision in favor of accession by a two-thirds majority. Over time, the GATT practice developed to fill in the details that Article XXXIII does not address.

Conceptually, and in practice, accession is a two-step process. First, the applicant must negotiate bilateral concession agreements with each WTO member that asks for one. Collectively, the members requesting bilateral agreements are referred to as an “accession Working Party.” The bilateral deals embody the applicant’s promises to individual members about opening its market on a government-to-government basis. They should not be confused with previously negotiated deals that the applicant may have made with particular members. Brand new agreements, or at the least, revisions to existing agreements are at issue here. These new agreements are the price of admission into the GATT-WTO system.

The need for this first step is not apparent from the language of

GATT Article XXXIII, which, after all, speaks to the joint action of the CONTRACTING PARTIES. Still, the process of forming bilateral concession agreements has become indispensable. What members will ask for such agreements? Those that have a keen export interest in the applicant's market. Therefore, the first step can be a tedious process. For commercially and politically significant applicants like the PRC and Taiwan, many members are sure to request bilateral negotiations. Roughly forty WTO members asked the PRC for bilateral concession agreements (including Australia, Brazil, Canada, Chile, the EU, Hungary, India, Japan, New Zealand, Norway, Switzerland, and the United States), and approximately twenty-six members (including Hong Kong and the United States) asked Taiwan for such deals. The accession of Saudi Arabia, Iran, and Russia are other examples demonstrating that many existing members will seek bilateral agreements. These agreements need not be identical - indeed, it is unlikely they will be. The members have some common, and some different, export interests. For example, in August 1998, Taiwan completed its bilateral agreement with the United States. Taiwan offered greater market-opening concessions to American agricultural products (specifically, beef and pork innards, and chicken) than it agreed to in its deals with the European Union ("EU") and Japan.

The second step is the negotiation of a protocol of accession with all WTO members, *i.e.*, with the WTO as a whole. Technically, the protocol is not the same thing as the decision of the CONTRACTING PARTIES referred to in GATT Article XXXIII. The decision is taken, and a separate protocol is drafted and approved. Thus, it could be said that accession actually involves three steps: bilateral concession agreements, the decision, and the protocol.

Obviously, the member states will not agree upon a protocol unless the first step is accomplished. When the demands of several members for bilateral concession agreements remain unsatisfied, those members will not support accession. To be sure, if only a few members remain unsatisfied, then they could invoke the non-application provisions of the GATT and WTO Agreements. At the same time, successful completion of the first step does not guarantee an easy negotiation for protocol of accession. To make matters even more complicated, the two steps may overlap.

The protocol represents the terms of entry into the WTO. It is, in

effect, a contract between the acceding party and the members in their joint capacity (the CONTRACTING PARTIES, in the language of GATT Article XXXIII). By implication, the members in their joint capacity are a separate legal entity under international law. Many of the arrangements made in the bilateral concession agreements become multilateral through the protocol. In fact, the bilateral agreements are incorporated into a schedule of commitments that is sent with the protocol, along with a report from the Working Party, to the WTO General Council for approval.

In addition, the protocol outlines the applicant's current trade laws and policies, while noting the differences between that regime and the minimum GATT-WTO requirements. The protocol explains how - and when - the applicant intends to correct these differences. Thus, for example, there might be a gap between the applicant's sanitary rules and the SPS Agreement, or its copyright laws and the Trade-Related Aspects of Intellectual Property Rights ("TRIPS") Agreement. The protocol identifies these problem areas and sets out the agreed plan of action for addressing them.

Finally, some applicants may want the protocol to indicate their status as a developing - or least developed - country so as to take advantage of the special and differential ("S & D") treatment afforded by many Uruguay Round agreements for such countries. The PRC, for example, argued vociferously for developing country status. Many WTO members may see this as a ruse to avoid trade obligations for as long as possible. Indeed, as intimated, aside from the problem of status, the question of "when?" often is crucial. Applicants may want to defer the reduction and elimination of tariff and non-tariff barriers for as long as possible. Extant members are sure to pursue the opposite goal in the protocol negotiations.

A sense of urgency often pervades these negotiations, particularly on the part of the applicant. The longer the negotiations drag on, the more likely the terms of entry will become more onerous. This is because the WTO members will agree among themselves to new trade liberalizing initiatives. For example, suppose a new trade negotiating round commences and results in a major market-opening deal on agriculture. A country that acceded before the new round had the opportunity to shape the terms of the deal, and in particular, the opportunity to make sure it can live with the terms. A country seeking

accession after the round will be stuck with a deal negotiated by others. Moreover, to use a track-and-field metaphor, "the bar will get raised." Many of the pre-round concessions the applicant made in bilateral negotiations during the first step of the accession process may, after the round, be deemed inadequate. After all, if the new round leads to greater liberalization among the members, then more will be expected of the applicant.

In the PRC's case, the sense of urgency spilled over to Taiwan. Taiwan was concerned that if it was not a WTO member by the time the planned Millennium Round was supposed to have commenced (early 2000), then the concessions it made in its bilateral agreements would be deemed inadequate by the WTO members. Taiwan feared it would have no choice but to liberalize more quickly and risk the shock that import surges would inflict on its economy. Taiwan considered the possibility of backing away from its "down payment" market access measures made to the United States if it did not gain WTO membership in the near future. After all, why implement these measures on the assumption of imminent accession if that event was far off? There was the "rub." Politically, Taiwan could not become a WTO member before the PRC. Thus, somewhat ironically, Taiwan was quite eager to see the PRC accede.

This irony suggests that despite the difficulties and complexities, negotiations on bilateral agreements and the protocol ought not be analogized to a war or even a non-violent zero-sum game. With respect to most if not all applicants, there is a shared interest among the applicant and the WTO members that the applicant accede. That shared interest may spill over to other applicants waiting in the queue, as in the PRC-Taiwan case. As long as an applicant remains outside the WTO, it bears no multilateral trade obligations. The applicant is responsible for performing only those requirements it has previously taken on through regional or bilateral trade and investment treaties. Likewise, WTO members bear no multilateral obligations to the applicant, and are liable only for the obligations they have previously assumed through a direct deal with the applicant. By joining the WTO, trade relations between the applicant and WTO members stabilize in a legal sense. Each side takes on clear, predictable multilateral obligations towards the other that are almost certain to be far more rigorous, in terms of demanding trade liberalization, than any previous bilateral arrangements. Moreover, the WTO has a

dispute resolution mechanism to adjudicate alleged breaches. In brief, the two steps ought to be thought of as a positive-sum game.

The benefits of this game extend beyond trade relations. An oft-made (and quite plausible) argument is that the PRC would be a better neighbor in Asia - and a more responsible world citizen - if it were welcomed into the WTO. To delay accession unnecessarily could isolate the PRC. It would punish the PRC's burgeoning middle class, the very people most likely to embrace democracy. Then, the PRC might turn inward, its human rights record might worsen, and its hand in Tibet might become all the heavier. Without accession, the PRC might also become increasingly hostile to the outside world, more inclined to settle matters - like the possible reunification of Taiwan, problems in Hong Kong, or the dispute over the Spratly Islands with several Asian countries - militarily.

A final point about the GATT-WTO accession process is worth mentioning. GATT Article XXVI:5(c) establishes a different procedure for accession for customs territories that have full autonomy in the conduct of external commercial relations. An existing contracting party responsible for the territory can sponsor it for membership. In 1950, Indonesia, sponsored by its former colonial master, the Netherlands, became the first country admitted under this provision. Starting in 1957 and for several years thereafter, several former colonies - Cambodia, Ghana, Laos, Malaysia, and Tunisia, for example - entered into GATT through the sponsorship procedure.

In contrast to Article XXXIII, the Article XXVI:5(c) procedure does not require a series of bilateral concession agreements, decision of the CONTRACTING PARTIES, or protocol of accession. Rather, the customs territory or newly independent country obtains membership on the same terms and conditions as those that had been accepted by its former colonial master on its behalf. For example, if the Dutch agreed to bind the tariff on imports of wheat into Indonesia at twelve percent, then Indonesia would have a tariff schedule with a twelve percent bound rate for wheat. Significantly, Indonesia would not inherit a concession on wheat if the Dutch had not made any. As another example, if the sponsoring contracting party elected to not apply GATT obligations to another party, then the sponsored entity would be deemed to have elected non-application to the same entity. (This occurred with former British colonies sponsored by the United

Kingdom. The British had avoided application of GATT to Japan when Japan acceded, and the colonies followed suit).

Under GATT Article XXVI:5(c) and procedures adopted during a 1957 GATT meeting, there is a period of *de facto* application of GATT obligations on a reciprocal basis between the contracting parties and the customs territory or newly independent country. During that period, the new country can adjust to the obligations, implement necessary trade policies, and decide whether it desires full GATT membership. An affirmative decision leads to full membership after a prescribed reasonable (though sometimes prolonged) period.

Does the sponsorship procedure have any relevance to the PRC? Obviously not, because its colonial history pre-dates GATT. Even if it did not, whether the PRC had the requisite autonomy in the conduct of its external commercial relations as required by GATT Article XXVI:5(c), under the spheres of influence of the imperial powers is dubious. However, at least in theory, the procedure could be relevant to Taiwan. If re-unification occurred and the PRC treated Taiwan as a separate customs territory, then the PRC could sponsor Taiwan. In practice however, the WTO members would likely object to applying the terms and conditions of the PRC's membership to Taiwan. They would argue that Taiwan, as a developed country, ought not receive any of the preferential treatment allowed to the PRC. Further, Taiwan undoubtedly would have its own objections to PRC sponsorship.

B. EARLY HISTORY: THE CURIOUS WITHDRAWAL

As indicated above, Cuba was an original GATT contracting party. After the communist revolution of 1959 led by Fidel Castro, it remains so, and was also a founding WTO member. China's story, however, is very different. The former Republic of China was an original GATT contracting party, but later internal political upheaval led to its withdrawal. On October 1, 1949, the PRC was founded, and the tattered remains of Chiang Kai-shek's Nationalist government fled to Taiwan. On March 6, 1950, the U.N. Secretary General received a communication from officials in Taiwan indicating that "China" was withdrawing from GATT. The withdrawal took effect on May 5, 1950.

The Mainland Communist government did not recognize the Na-

tionalists' action, and contested the validity of this withdrawal. It argued that the withdrawal was null and void because it was attempted when the Communists controlled the mainland, hence Chiang Kai-shek's government did not have the right to represent China. Put in public international law terms, the PRC argued for application of the law of succession - it should be recognized as the legitimate successor government in China. In rebuttal, however, it can be said that the "China" that was an original contracting party and the "China" that withdrew was the Republic of China, headed by Chiang's Nationalists. The Communist government on the mainland represented a different sovereign entity; a China that had never been a part of GATT. In other words, the PRC was not a successor government to the Nationalist one, but an entirely new creature. Plainly, the arguments involve politically charged questions of recognition, and whether there is one China or two. Whatever the merits of the conflicting positions, the fact is that for the twenty years following the withdrawal, the PRC played virtually no role in GATT affairs. Mao Zedong simply did not much care about them.

In January 1965, the CONTRACTING PARTIES granted Taiwan's request to join GATT as a non-voting observer. In 1971 the U.N. General Assembly voted to restore all the rights of China in the U.N. to the PRC. Accordingly, the PRC became a full member of the General Assembly and permanent member of the Security Council. Additionally, the PRC obtained representation in specialized U.N. agencies. While GATT was not such an agency (nor is the WTO), GATT followed U.N. policy decisions. In seating the PRC delegation, the U.N. decided the PRC was the sole legitimate government of China. Hence, GATT revoked Taiwan's observer status. Curiously, the PRC elected not to seek membership in GATT in 1971 - an otherwise auspicious year for the PRC's international status. The reasons for this decision may lie in the internal upheaval in the PRC associated with the Cultural Revolution of 1966-76, the preoccupation of PRC leaders with President Nixon's dramatic "opening" to China, or perhaps even Mao's declining health.

C. THE FIRST STEPS TOWARD MEMBERSHIP

However, in August 1980 - coinciding with the post-Mao liberalization period - the PRC sent a delegation to the GATT Secretariat in Geneva and applied for participation as a non-voting observer. The

CONTRACTING PARTIES granted the request in 1982 and the PRC began to participate regularly as an observer in meetings, including the Uruguay Round negotiations. On December 15, 1983, the PRC signed the Multi-Fibre Agreement ("MFA"), which took effect on January 18, 1984. The MFA became the major legal instrument for regulating international trade in textiles through a complex quota system.

The year 1986 was a watershed in the PRC's efforts to join GATT. In January, then-Director General of GATT, Arthur Dunkel, visited the PRC. On April 23, in accordance with the 1984 Sino-British Joint Declaration on the future of Hong Kong (plus an agreement reached in March on this subject), Her Majesty's government sent a note to the GATT Secretariat concerning the status of Hong Kong. The United Kingdom proclaimed that Hong Kong was a contracting party pursuant to Article XXVI:5(c) of GATT. That provision allows a customs territory (*e.g.*, Hong Kong) of a contracting party (*e.g.*, the United Kingdom) to itself be deemed a contracting party when the territory gains independence in the conduct of its external commercial relations. Simultaneously, the PRC sent a note to the GATT Secretariat indicating that it would resume sovereign control over Hong Kong on July 1, 1997, and would establish the Hong Kong Special Administrative Region ("SAR"). The Hong Kong SAR would continue as a contracting party under the title "Hong Kong, China."¹ Most importantly, on July 10, 1986, the PRC requested that its status as a contracting party to GATT be restored.

The PRC wanted to join GATT and become a WTO member out of rational economic self-interest. Entry would mean lower tariffs for Chinese goods by virtue of the Most Favored Nation ("MFN") status and tariff binding principles of Articles I and II of GATT. For example, in 1994 the PRC produced one-seventh of the world's clothing and shoes. Until entry, these products faced tariffs as high as twenty-three percent in the EU and forty-nine percent in Australia. Membership would mean the average duty imposed by developed countries on Chinese clothes and shoes would drop to 4.8 percent. As another

1. The Macao SAR benefits from a similar arrangement, worked out between the Portuguese and PRC governments in 1991. On December 20, 1999, China resumed sovereign control over Macao, which continued to be a contracting party under the name "Macao, China."

example, in 1994 half of all Chinese products entering the United States faced Non Tariff Barriers (“NTBs”), mainly quotas. If the PRC became a member, these barriers would no longer apply. Overall, in 1994 the World Bank estimated that China’s greater access to foreign markets as a result of accession to GATT and membership in the WTO would lead to a thirty-eight percent increase in PRC exports.

The PRC understood that entry also meant political benefits. Not only would the PRC become entitled to MFN treatment from the United States (as well as all other WTO Members), but it would escape the embarrassing annual reviews of such treatment under the Jackson-Vanik Amendment. To be sure, Congressional action to modify the Amendment would be necessary to remove the PRC from coverage of its terms and assure permanent MFN status. Still, it seems reasonable to believe that if the United States were willing to support accession, which would mean incurring the GATT Article I MFN obligation, then it would take the legislative steps necessary to end the annual MFN review process.

Fundamentally, to put the matter in blunt Asian terms, entry would give great “face” to the PRC. It would signify that the PRC is no longer a second-class country, but rather an accepted equal partner in the international economic community. The PRC is also quick to point out that its accession would mean great “face” for the WTO: the WTO hardly is worthy of its name—World Trade Organization—until the world’s most populous country joined its ranks.

The PRC’s enthusiasm for rejoining GATT and obtaining WTO membership was not universally shared. As Douglas Newkirk, a former Assistant United States Trade Representative, commented, “[t]he GATT wasn’t written with a socialist market economy in mind.” The PRC’s transition from a communist to a market economy, and the often-repeated, oxymoronic declaration by its elder leaders that it has a “socialist market economy,” complicated the entry process. The PRC has no choice but to assume certain obligations and make specific commitments in order to become part of the GATT-WTO regime. These burdens were the subject of intense, heated negotiations conducted under the auspices of the GATT-WTO since 1987.

D. THE FAILED EFFORT TO BECOME A FOUNDING WTO MEMBER

To consider the PRC's application for entry, GATT established a "Working Party on China's Status as a Contracting Party" in March 1987.² Subsequently, the PRC imposed a unilateral deadline of January 1, 1995, for re-entry. This was also the date the WTO was formally established, because the PRC wanted desperately to be a founding member of that institution. Here, "face" was more important than political realities or legal technicalities. For the most part, the same benefits and burdens established under GATT and the Uruguay Round agreements accrue to a country whether it is a founding member or joins later - from a legal perspective, there is no rush.

The PRC's deadline proved a rather clumsy and ineffectual effort to pressure the international trade community. From 1987-95, the Working Party met over twenty times to consider the terms of a protocol under which the PRC would accede to GATT and become a founding WTO member. Among the issues discussed were: 1) the PRC's tariff barriers (which at the time averaged thirty-five percent, far in excess of those of contracting parties); 2) NTBs such as the lack of transparency and uniformity of the PRC's customs requirements and other trade laws; 3) market access for foreign financial services; 4) government subsidies to state-owned enterprises; 5) the convertibility of PRC currency - the yuan (or renminbi); 6) Chinese labor standards; and 7) enforcement of Chinese intellectual property laws.

An exceptionally difficult issue for the Working Party was whether the PRC would gain admission as a developing or developed country. For many purposes, developing countries are accorded S & D treatment under GATT and the Multilateral Agreements on Trade in Goods. For example, the Working Party may suspend certain obligations in order to pursue pressing economic development interests, or they may phase them in over a longer period of time than applies to developed countries. In addition, developing countries are entitled to the benefits of the General System of Preferences ("GSP"). The PRC was anxious to secure these advantages. However, the United States, under strong pressure from American businesses, insisted that

2. In December 1995, following the birth of the WTO, it was renamed the "WTO Working Party on the Accession of China."

China join the WTO as a developed country. No other member of the Working Party was prepared to grant the PRC all the exemptions permissible under the GATT-WTO regime for developing countries - with the exception of the EU, which indicated in 1994 that it might support the PRC's accession on the basis of less stringent requirements than those advocated by the United States.

This appearance was a harbinger of real division among the United States, EU, and Japan over the terms of Chinese accession. The United States wanted the PRC to meet all the criteria necessary for accession at the time it entered the WTO, and sought a unified front in advancing this position. In contrast, the EU and Japan were willing to settle for the PRC fulfilling some requirements upon entry, and committing to meet other goals after a post-accession transition period. In effect, the Europeans and Japanese were playing the role of "good cop," thereby casting the Americans in the role of "bad cop" and forcing the United States to do the "heavy lifting" in the negotiations. The United States feared division in the ranks would facilitate the PRC's preferred strategy of handling countries individually and playing one off against another to gain advantage.

The United States also raise a related concern, about the PRC's State Owned Enterprises ("SOEs"). The PRC claimed many of the SOEs operate according to market principles. The United States countered that state ownership confers control and direction that was inconsistent with a free market economy, and that government agencies and SOEs controlled seventy-five percent of the Chinese economy. The United States also noted the PRC's refusal to agree to publish quotas on state-traded agricultural products. Yet, the PRC could not be expected to shut down its SOEs overnight. Millions of workers would lose their jobs, possibly resulting in social disruption, even anarchy, on a scale that would make the problems at Tiananmen Square in 1989 seem mild by comparison. The PRC insisted that it, and not the United States, would decide the timetable, according to its own economic development needs and political context.

The PRC had good reason for concern. In February 2000 - shortly after the United States and the PRC signed their bilateral agreement - over 20,000 workers at the Yangjiazhangzi Mine (about 250 miles northeast of Beijing) and their families rioted, burning cars, barricading streets, smashing windows, setting fires, and fighting the

People's Armed Police. (Yangjiazhangzi was the largest non-ferrous mine in the PRC, once supplying thirty-five percent of China's output. It produced molybdenum, which is used to make airplanes, rockets, and X-rays, because it can withstand high temperatures.) The People's Liberation Army was only able to restore order by firing shots above the crowd.

The protest was a reaction to the Communist Party's announcement that, as part of the effort to accelerate the closure of inefficient SOE's in anticipation of WTO accession, it was closing the mine. The Party declared a one-time severance package for each miner of 560 renminbi, about \$68 for each year worked at the mine, and that miners would have to pay for their own social security and health insurance. Even in China's impoverished northeastern "rust belt," the \$68 figure was paltry. A family of three could live on \$68 at a meager level for about a month.

Given that the PRC would have to close thousands of SOEs—not just mines, but also cement factories, steel mills, textile factories, and the like—Yangjiazhanzi was a frightening symbol of what was to come. Where would the central government get the money to supply pension and welfare services for redundant workers? How could tax revenues cover the financing burden, when the entities being taxed were losing money? How could the central government shift the burden to local taxing authorities, who did not want the pressure of imposing ever-higher fees on local businesses? And, of course, how could they maintain law and order amidst the transition?

Still another troublesome issue concerned Taiwan's application for membership in the GATT-WTO regime, submitted on January 1, 1990. Taiwan - which boasts one of the world's largest economies and is one of the top fifteen trading powers - pledged to join as a developed country. In September 1992, the GATT established a formal Working Party to handle the application.

Acting in accordance with its policy favoring the reunification of the PRC and Taiwan, and the maintenance thereafter of Deng Xiaoping's "one country, two systems" policy, the PRC demanded that the Contracting Parties withhold approval of Taiwan's application until its own application was accepted. Perhaps as an ineluctable pragmatic accommodation, Taiwan agreed it should not become a GATT contracting party (or WTO Member) before the PRC - the

famous “no earlier” arrangement. The arrangement had policy logic to it. If China was one country but two systems, then Taiwan could join only as a separate customs territory of China (like Hong Kong, not as a sovereign nation), which presumed that China already was in the club. The Chairman of the GATT Council negotiated a deal in 1990 underscoring this arrangement. The Council would examine the reports of the Working Parties on the accession of the PRC and Taiwan independently, but it would consider and adopt the PRC’s materials first.

That is not to say Taiwan opposed the PRC’s application. To the contrary, Taiwanese officials tended to view accession of both Taiwan and the PRC as a device to reduce tensions between them. (The PRC, of course, regards Taiwan as a “renegade province” and has not foresworn forceful reunification). How so? Liberalization of trade barriers through accession should boost economic ties. By September 1999, over 40,000 Taiwanese companies had invested in the PRC. Taiwanese officials predicted this Taiwanese Foreign direct Investment (“FDI”) would lead the PRC to import more from Taiwan - if the PRC’s import barriers were reduced.

Interestingly, the virtual certainty of the PRC acceding before Taiwan raised the prospect that the PRC could demand a bilateral concession agreement with Taiwan as a precursor to Taiwan’s own entry. That would give great “face” to Taiwan, essentially elevating it to an independent state like its archrival. To avoid this possibility, it was suggested in February 2000, that any protocol of accession for the PRC not take effect until after thirty days. During that month, Taiwan could be offered a protocol. That way, Taiwan would join the WTO “after” the PRC, but before the PRC had become a member empowered to call for a bilateral deal.

In any event, given all the difficulties, the PRC’s deadline for entry proved impossible to meet. In the Working Party, the United States and EU on the one hand, and the PRC on the other hand, bitterly disagreed over the PRC’s offers to liberalize its laws governing international trade. The Americans and Europeans argued the Chinese proposals regarding its protocol for accession did not sufficiently liberalize market access to foreign goods and services. For example, the PRC was unwilling to change certain laws that favored Chinese over foreign firms, a violation of the national treatment

principle.

United States-Sino bilateral trade relations had an important effect on the PRC's application to become a founding WTO member. In October 1991, the United States Trade Representative ("USTR") initiated an investigation into Chinese market barriers under Section 301 of the Trade Act of 1974, as amended ("1974 Act"). These barriers included failure to publish trade-related laws, regulations, judicial decisions, and administrative rulings, NTBs such as import licensing requirements and quantitative restrictions, and restrictive product standards, testing, and certification requirements. After one year of negotiation, the United States and PRC resolved the investigation by signing a bilateral Memorandum of Understanding ("MOU"). Pursuant to the MOU, the PRC agreed to eliminate certain market access barriers over a five-year period. In return, the United States agreed to liberalize certain export controls on goods for the PRC, and support the PRC's goal of becoming a WTO member.

On April 16, 1994, the PRC signed the Final Act Embodying the Results of the Uruguay Round and the WTO Agreement. Nonetheless, from the American perspective, the PRC's implementation of its commitments set forth in the 1992 MOU was a key indicator of its readiness to undertake GATT-WTO obligations. By October 1994, the USTR still had numerous concerns about the PRC's international trade law regime. Here are some examples:

- *Transparency.* The PRC's trade laws and regulations lacked transparency. For example, some quotas were not published. The PRC needed to guarantee that only published rules would be enforced.
- *Tariffs.* In various sectors, the timetable for reducing tariffs, including the number and level of tariff peaks, was either unspecified or too long. The problem was acute in certain industries that remained protected by extraordinarily high tariffs. For instance, duties on imported autos ranged between eighty to 100 percent.
- *NTBs.* The PRC needed to eliminate non-tariff measures, such as quotas, not permitted under GATT 1994, within an acceptable period.
- *Subsidies.* The PRC needed to phase out industrial subsidies prohibited by the Uruguay Round Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). Given the extent of

SOEs in the PRC, this point was particularly acute. The GATT-WTO regime is designed for market economies. GATT says very little concerning SOEs. Yet, much of the Chinese economy remained (directly or indirectly) in state hands, and the state subsidized its economic agents in many ways. For example, it arranged for cheap loans from Chinese banks.

- *Trading rights.* The PRC needed to expand trading rights for foreign companies by allowing them to import and export without a license. The PRC also needed to eliminate its designated trade rules, *i.e.*, rules limiting the trading rights of certain firms to trade in a limited array of specified products.

- *Uniformity and the rule of law.* Trade rules often varied haphazardly from one Chinese province to the next. The PRC needed to provide assurances it could apply GATT-WTO obligations uniformly across regions and provinces. More fundamentally, it needed to upgrade its rudimentary legal system to ensure the rule of law was observed throughout the country. All too often, decisions were made on the basis of *guanxi* (personal relationships and connections).

- *National Treatment.* The PRC needed to extend national treatment to imported goods and to foreign companies operating in the PRC, particularly in the services industry.

- *Pricing.* The PRC needed to phase out state-fixed prices, and thus allow market forces to determine prices. This concern was a clear manifestation of the challenge the PRC faced in moving toward a full market economy.

- *Intellectual Property Rights.* The PRC needed to provide meaningful protection for patents, copyrights, trademarks, and semiconductor mask works by enacting and enforcing appropriate legislation.

- *Safeguards.* The United States and other WTO Members would need a special safeguards clause, in addition to GATT Article XIX, to protect their industries against sudden surges of Chinese exports that were anticipated once they lowered trade barriers to Chinese goods upon accession. In other words, the United States and other WTO Members feared their usual defenses against cheap manufactured imports would be overwhelmed, so they demanded a trade remedy tailored for use against the anticipated increased competition from the PRC.

- *Agriculture.* The PRC needed to reduce non-tariff measures on agricultural products so foreign products could enjoy greater market access. For example, quality inspections were often tougher for imports than for domestic products.

- *Foreign exchange.* The PRC needed to allow the yuan to be freely convertible. This concern was another manifestation of the problem of moving toward a full market economy.

The USTR linked the PRC's request for developing country exemptions with appropriate commitments from the PRC on the above issues.

E. ACCESSION NEGOTIATIONS IN 1996-98: THE AMERICAN POSITION

During the mid and late 1990s, the United States repeated its bottom line position on Chinese accession so often it became a mantra: it supported the PRC's application, but entry must be on "commercially meaningful terms." Most of the USTR's concerns as of October 1994 (listed above) remained sticking points in the late 1990s. During 1996-98, additional points of dispute flared:

- *Prison and Child Labor.* The PRC needed to make progress toward the elimination of exports of products made with prison or child labor.

- *Trading rights.* The PRC seemed willing to grant increased trading rights to foreign companies, *i.e.*, the right to import and export products, particularly the right to do so without going through a Chinese middleman, but they still wanted to maintain several problematic restrictions.

- *Distribution rights.* The PRC had not agreed to grant distribution rights - such as wholesaling, retailing, maintenance and repair, and transportation - to foreign companies. In other words, foreign companies could not own and operate distribution networks within the PRC. These networks were controlled by state-run Chinese companies. A foreign firm could not conduct marketing, after-sales service, maintenance and repair, and customer support unless its business license from the government allowed it to do so. Yet, distribution was a service and, pursuant to the General Agreement on Trade in Services ("GATS"), was a legitimate subject for negotia-

tion. While the PRC had guaranteed foreign companies would have equal access, along with domestic firms, to distribution and transportation networks, the PRC needed to grant foreign companies the opportunity to set up and control these networks so they could get their wares to market. American companies like Amway, Avon, and Mary Kay Cosmetics, which relied on direct selling, were examples of foreign firms whose access was limited by the PRC's strictures.

- *After-sales servicing.* The PRC needed to scrap its rule that foreign manufacturers provide after-sales service through a domestic Chinese company. This rule added unnecessary costs, and adversely affected the ability of foreigners to provide service and control inventory.

- *Foreign Direct Investment:* No foreign company could invest in the PRC without a Joint Venture ("JV") partner. In many instances, the foreign partner was limited to a minority stake. Moreover, the PRC often imposed performance requirements as a condition of approving an Foreign Direct Investment ("FDI") project. For example, it would condition permission on technology transfer, export requirements, local content usage and other offset arrangements, or foreign exchange balancing. The PRC needed to eliminate these restrictions and allow for freedom of FDI.

- *Financial services.* While the PRC had given licenses to a lucky few foreign commercial banks to conduct business in local currency, and then only in Shanghai and Shenzhen, most banks were barred from these activities. Even those lucky few were limited to taking deposits and making loans in local currency to foreign-invested companies. The PRC needed to allow foreign banks to compete on equal footing with Chinese banks in these lines of business, specifically by accepting deposits from, and lending to, Chinese business and individual customers.

- *Telecommunications.* The PRC was willing to permit just two telecom JVs in two cities, and limiting the foreign partner to a 25 percent equity stake. This sort of experimental liberalization was insufficient. Indeed, aside from this experiment, the PRC banned all FDI in the telecom sector. Moreover, the PRC placed significant geographic restrictions on the provision of paging, value added, closed user group, mobile and cellular, and domestic wireline services.

- *Agriculture.* Fresh agriculture disputes had arisen between the United States and the PRC. The PRC allegedly used Sanitary and Phytosanitary Standards (“SPS”) restrictions to keep out American agricultural products like citrus, meat, stone fruit, and wheat, with no scientific justification for doing so.

- *Textiles.* The PRC allegedly circumvented American textile import quotas by illegally trans-shipping billions of dollars worth of textiles, resulting in the loss of tens of thousands of American jobs. Moreover, the PRC wanted to protect its textile industry for several years after it entered the WTO.

Thus, the United States, joined by the EU, rejected proposals in 1996 by some Asian political and business leaders calling for the PRC to be a conditional WTO Member. Their idea was that conditional membership would be a grace period for the PRC to improve its commitment offers, and take on some of the obligations of WTO membership.

The United States continued to reject the PRC’s position that it be treated as a developing country. The United States said the sheer size of the PRC as a global trader dictated that it enter the WTO without S & D treatment. In 1996, the EU offered a compromise: the PRC would make a “down payment” by agreeing to some obligations immediately upon accession, and would phase in the remaining obligations over a period of years agreed to by the negotiating Members and the PRC. The result would be that the “breathing space” would be a negotiated matter, not mandated by the Uruguay Round agreements, because the WTO would not consider it a developing country. In December 1996, the PRC accepted a variant of this compromise: it dropped its demand for comprehensive developing country status, and agreed to negotiate transition periods only for industrial sectors genuinely in need of S & D treatment owing to serious adjustment difficulties.

The United States articulated its position to the Chinese before and during President Jiang Zemin’s state visit in October 1997. The frank exchanges produced no tangible results - other than increasing mistrust and hard feelings. Nowhere was the phenomenon of the two sides talking past one another more apparent than in a White House press conference held jointly by Presidents Clinton and Jiang. Asked about the meaning of the Tiananmen Square incident, President

Clinton spoke eloquently of the American belief that a country is made stronger through pluralism and the free interchange of ideas. President Jiang was impressive in his defense of the traditional Asian view of the essentiality of order and stability for progress. President Clinton countered that the PRC's theories of political economy were on the wrong side of history. WTO accession seemed further away than ever. The two sides had not yet even moved beyond Tiananmen, and could agree only to disagree on how to read that history. About the only positive trade outcome from the summit was the PRC's announcement that it would join the separate Information Technology Agreement ("ITA"), signed in March 1997.

The prospects for WTO accession dampened further. First, America's bilateral trade deficit with the PRC yawned. (Indeed, in January 1999, the PRC became America's largest source of trade imbalance, overtaking Japan.) Beijing argued that American customs statistics distorted the true picture, because re-exports from the PRC through Hong Kong were included. That argument, however, became unconvincing when the PRC resumed sovereignty over Hong Kong on July 1, 1997. The better argument—that many exports from the PRC were from American Multinational Corporations ("MNCs") operating there—fell on deaf ears. Second, and of far greater political importance, in late 1997 and into 1998, the Clinton Administration was rocked by charges that the Democratic Party had accepted illegal campaign contributions from the PRC during past campaigns, raising serious questions about Chinese influence over the outcome of an American presidential election.

F. ACCESSION NEGOTIATIONS IN 1996-98: THE DEBATE IN THE PRC, CHINESE CONCESSIONS, AND THE AMERICAN REPLY

At times during 1996-98, signals emanated from Beijing suggesting the PRC was losing interest in WTO membership. Economic problems associated with domestic reform and effects of the Asian economic crisis plagued the PRC. Reformers in the government - including the pro-accession Ministry of Trade and Economic Cooperation ("MOFTEC") - clashed with powerful domestic interests over the nature and speed of change in this perilous environment. The People's Liberation Army feared losing control over telecommunications to foreign companies, SOEs - including banks and insurance companies - and their guardian ministries feared losing market share

to foreign companies, farmers feared they could not compete with foreign agri-business. For ailing SOEs, even a generous transition period would be a suspended death sentence. Reformers also were under siege from officials who argued the tariff reduction and other market-opening concessions that would be necessary for entry would be too painful for private-sector, infant Chinese industries to bear. These officials pointed out the PRC already enjoyed bilateral trade relations with nearly 200 countries (and large surpluses with many of them), most or all of which included MFN treatment, so what value added could there be from WTO membership? In fact, in addition to the market-opening concessions it would have to make, maybe the PRC would be made worse off by the Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes ("Dispute Settlement Understanding", or "DSU"). After all, resolving disputes bilaterally put the PRC in an advantageous position because of its size: it could be a bully if it so chose. The DSU put all WTO Members on a level dispute resolution field.

To be sure, some of the reluctance to meet stiff conditions for WTO entry was rooted in the privileged status a few officials enjoyed and used corruptly to enrich themselves. Graft and smuggling were not uncommon among many (especially mid and lower level) functionaries. There was, however, more than personal gain at stake. Consider the American demand that foreign banks be allowed to deal in yuan and take deposits from local customers, along with its demand for an end to state subsidization of SOEs. SOEs employed more than two-thirds of all urban workers (*i.e.*, more than 150 million people), and provided them with all of their health and social benefits. If both demands were met, a monstrous crisis faced the Chinese economy. Bad loans made over the years to SOEs enfeebled Chinese banks. SOEs absorbed about eighty-five percent of bank loans in the PRC, but produced less than one-third of the PRC's output. Yet, the weak Chinese banks would be subject to unbearable competition from foreign banks. The SOEs themselves would lose their subsidies, and also be subject to foreign competition in their respective sectors as per market access commitments. Therefore, the SOEs would be even worse off than before, and repayment of their loans to Chinese banks would be severely imperiled. In turn, Chinese banks would collapse under the dual weight of non-performing loans and foreign competition from the likes of Citibank and other well-

capitalized behemoths. The Chinese populace would panic: there would be runs on the banks, and ultimately, civil unrest.

No responsible government of the PRC could let this scenario materialize. Better to "go slow" on trade liberalizing commitments, even if that meant deferring WTO membership, until the Asian economic crisis had passed and the salubrious effects of reforms initially unleashed by Deng Xiaoping in the early 1980s had put the economy in a strong position to withstand foreign competition. Indeed, the Chinese insisted on promoting so-called "pillar" industries: cars, construction, electronics, machinery, and petrochemicals. These industries would be the principal muscles of the Chinese economic giant of the new millennium. They needed protection until they were sufficiently well developed. For instance, the Chinese said they did not want to import any foreign-made cars for up to fifteen years after WTO accession. Any wholly-owned domestic car companies, along with Western and Japanese car companies with Joint Ventures in the PRC, thus would be safe from competition from imports. To the United States, the Chinese approach to its pillar industries smacked of industrial policy - marshaling domestic resources to build up favored industries, and keeping out foreign competition in the meantime. The Americans found it fundamentally at odds with the PRC's supposed goal of moving to a full market economy, and inconsistent with the free-market principles underlying the GATT-WTO regime.

In addition to rigid concerns about the pace of domestic economic liberalization and market opening, some Chinese officials openly espoused nationalistic arguments against bending to America's intransigent demands on the terms of WTO accession. The Americans were treating the PRC not as a strategic partner, but as a competitor, even a threat to be contained. In December 1996, Wu Jiahuang, the Director-General of the Tariffs Department of the General Administration of Customs, said the PRC had become "indifferent and doesn't care anymore" about WTO accession because of "excessive demands." He dubbed the entry bid a "sunken boat."

Was there a kernel of truth in the nationalistic position? Along with the EU, the United States was demanding heavier concessions from the PRC as the price of WTO admission than had been required of most poor countries. For instance, both the United States and the EU asked the PRC to reduce its tariffs below those in many Less De-

veloped Countries ("LDCs"). Services were another example. The PRC was supposed to roll back barriers to foreign banks, securities firms, insurers, and telecommunications providers to a far greater degree than many LDCs. Still another example was the insistence on safeguards in addition to GATT Article XIX. Any additional safeguard mechanism aimed particularly at Chinese import surges would be blatantly discriminatory, and obviously would reduce the value of the GATT Article I:1 obligation of existing Members to the PRC after it joined.

Still, the pro-accession forces in the Chinese government maintained the upper hand. They admitted some Chinese industries would suffer from increased import competition. They argued, however, that the advantages of membership would outweigh the disadvantages. It was a delectable neo-classical economic argument, cast in Chinese terms of course: trade liberalization would result in a net gain to society, and perhaps the winners could compensate the losers. Thus, during 1996-97, the "internationalists" in Beijing were able to offer a number of concessions on issues of concern to Washington. For example:

- *Standstill.* The PRC would not enact any new laws, or implement any new policies that were inconsistent with WTO principles. In other words, the PRC would not replace market-opening measures with new barriers.
- *Tariffs.* The PRC re-affirmed a commitment it had made initially in 1995 to decrease its average un-weighted tariffs on non-agricultural products to fifteen percent by the year 2000 (seventeen percent by 1998). The PRC reminded the United States that it already had made dramatic cuts in industrial tariffs, from an average of 42.7 percent in 1992 to twenty-three percent by December 1996. (The United States countered that twenty-three percent was the highest average in APEC. However, by September 1999 the PRC's average industrial tariff rate had fallen to 16.7 percent.)
- *Quotas.* The PRC would offer to phase out import quotas on cars and mini-buses within eight years. Upon accession, it would abolish quotas for sixty-six items, including sugar. More generally, the PRC promised, if it acceded before 2005, it would abolish all NTBs by then. It also reminded the United States that between 1992-98, it had reduced, or was planning to reduce, NTBs from 1,247 to

less than 400.

- *Trading rights.* Within three to five years of joining the WTO, any firm (foreign or domestic) would be able to import goods into China, or export them from China, without a license. With no licensing requirement, Chinese SOEs would lose their monopoly on trade with the outside world. Moreover, foreign companies and Chinese companies would be able to trade directly with each other: no longer would they need to trade only with and through certain state trading corporations.
- *SOEs.* The import purchasing procedures of SOEs would be transparent and comply with WTO rules.
- *Non-discrimination.* Foreign companies would be guaranteed national treatment as regards the pricing and procurement of goods and services offered for the domestic market.
- *FDI.* In many industries, it no longer was necessary to invest in the PRC through a JV. The requirement that a JV must export as much as it imports, and that it must earn as much foreign exchange as it buys, was removed. The obligation on JVs to buy Chinese raw materials and components, and to export a minimum amount of their production (sometimes as much as ninety percent of output), would be dropped in the future.
- *Financial services.* The PRC would allow a larger number of foreign branches to operate in the banking, insurance, and securities sectors.
- *Foreign exchange.* In 1996, the PRC made the yuan convertible on the current account. It agreed to work toward making the yuan convertible on the capital account as well.
- *Intellectual Property Rights.* The PRC already had closed down many factories making pirated software and video-cassette disks. It pledged to continue to do so. In addition, it would accept all of the terms of the TRIPS Agreement upon accession, and would not ask for the S & D treatment that Agreement affords to developing countries.
- *Agriculture.* The PRC would ban export subsidies, though it would reserve the right to support farm prices.
- *Transparency.* The PRC agreed it would enforce only published laws and regulations, it would make translations available, and

WTO Members would have the opportunity to comment on proposed new rules before they took effect.

- *Rule of law.* The PRC agreed to establish independent tribunals to review all administrative actions questioned by foreign traders.

- *Subsidies.* All WTO-inconsistent subsidies (including agricultural export subsidies) would be phased out.

Moreover, in October 1997, Sir Leon Brittain, the EU's trade commissioner at the time, announced the Chinese agreed to four principles to accelerate WTO accession:

- *Discrimination.* The PRC would not discriminate against imported goods or foreign companies.

- *Quotas.* The PRC would phase out all import quotas according to a clear schedule.

- *Tariffs.* The PRC would eliminate most of its tariff peaks, and cut tariffs by more than one-third, to below the average in LDCs.

- *Services.* The PRC would offer more balanced and equitable access to foreign service providers, in part by providing more banking and insurance licenses to foreign companies.

The concessions and agreed-upon principles were significant. For instance, were it considered a developing country, the PRC could keep agricultural export subsidies during a transition period. Hence, the PRC was surrendering a right to which it arguably was entitled. In addition, the elimination of quotas for cars and mini-buses over an eight-year period was a major change from the initial Chinese position in favor of a fifteen-year period, and from the previous offer of twelve years.

The PRC also argued that during the 1997-98 Asian currency crisis, it had not devalued the yuan.³ Devaluation would have served the PRC's mercantilist interests - lowering the cost of its exports relative to products from other Asian countries. The PRC, however, argued it had behaved responsibly and eschewed this course because it did not want to catalyze a round of competitive devaluation in Asia reminis-

3. The PRC has continued to say it would not do so, though there was talk in November 1999 of widening the band in which the yuan was allowed to trade against the United States dollar.

cent of the beggar-thy-neighbor policies of the 1930s.

Although the United States was relieved, it was unmoved. A country had to be more than merely responsible in its international economic policy to warrant WTO accession. Moreover, avoiding devaluation served the PRC's own interests. Devaluation would raise the cost of imports of raw materials and machinery, which the PRC needed to fuel its industrial growth. It would put immense pressure on the Hong Kong dollar peg - HK \$7.8 to U.S. \$1 - which was a cornerstone of stability for the PRC and had weathered strong speculative attacks from foreign exchange traders. Furthermore, many of the products the PRC exported were not substitutable with those from other Asian countries. Japan, Korea, and Taiwan all exported higher value-added products, so a devaluation of the yuan would not necessarily help the PRC's competitive position in the region.

What about the PRC's better argument - that reformers had carried the day and offered major new concessions, of the likes listed above, to merit WTO accession? The United States was unimpressed, and it remained so even after President Clinton's summit in Beijing with President Jiang in June 1998. It found some of the concessions offered by the PRC to be half-hearted and the Sir Leon again was introducing division in the allied ranks by playing "good cop."⁴ For example, the PRC's promise to eliminate WTO-inconsistent subsidies seemed impressive. The PRC, however, was vague about assuring transparency with respect to identifying the nature, amount, and beneficiaries of the subsidies. Another example was the PRC's promise to eliminate the need for foreign companies in order to trade only with or through certain SOEs. The PRC wanted to retain state trading arrangements for eight products it regarded as basic necessities (*e.g.*, fuel, grain, and wool), and it sought transition periods of three to five years for an additional six products (*e.g.*, rubber and timber) in which between sixty to 100 Chinese companies had exclusive trading rights. Worse yet, the overall ostensible equality of treatment as between foreign and Chinese companies with regard to trading rights was a chimera. Although the PRC did not allow for-

4. The divisions would soon worsen. New Zealand announced in the fall of 1997 it was satisfied with the terms the PRC was offering in their proposed bilateral agreement.

eign companies to import goods, distribution still required government-run trading houses.

The Americans also found examples of empty commitments. First, the promise of a standstill was undermined by new and proposed protectionist measures. For instance, in mid-1997 the PRC's Ministry of Labor issued new rules for safety inspections of imported pressure valves, boilers, and valves used in power generators and textile mills. Foreign companies using these imported items had to pay for Chinese inspectors to travel to every factory that supplied parts for these items and certify that those plants complied with unspecified safety regulations. The total cost borne by foreign companies per inspection was approximately \$100,000 - a \$15,000 fee, plus travel expenses. Moreover, many inspectors worked for research institutes with ties to Chinese companies that made similar equipment, leading to the possibility of industrial espionage. Hence, industrial espionage could occur.

Regarding FDI, the PRC proposed to end the rule that a foreign company must balance its trade, *i.e.*, that it must export products to raise foreign currency, or simply import the needed currency. That rule was designed to ensure that when the company needed foreign currency to pay for imports it needed for its production process, or for capital goods, the company would not obtain the currency by buying it locally and thus deplete the PRC's own foreign exchange reserves. Yet (as in the above list), in 1996 the PRC had made the yuan convertible on the current account. That decision meant foreign companies could buy foreign currency for the purpose of importing goods and services. They no longer had to export their goods from the PRC to get hard currency, nor did they have to import hard currency.

E. THE LOW POINT: EARLY AND MID 1999

By the end of 1998, a bilateral concession agreement - not to mention a protocol on accession - was nowhere in sight. Each side was fed up with the other. To the Chinese, the Americans were pushing too hard. To the Americans, the Chinese approach was desultory. Amazingly, the situation got worse before it got better. In the long history of the PRC's efforts to join the GATT and WTO, no discrete period was as replete with negative developments as the first

half of 1999. In April, Chinese Premier Zhu Rongji visited the United States amidst high expectations that the two sides would finally reach an agreement. Indeed, they had been negotiating feverishly in March, with the USTR, Ambassador Charlene Barshefsky, visiting Beijing twice that month. Premier Zhu was personally enthusiastic about joining the WTO, and wanted to wrap up a deal after thirteen years. During the Premier's trip, the Chinese made significant additional concessions on market access. For example:

- *Tariffs.* The average tariff rate on industrial products would be reduced from 24.6 percent to 9.44 percent. Two-thirds of this reduction would be implemented by 2003, and, with a few exceptions, the balance by 2005. But even for the most important exception, vehicles (including cars), the reductions would be dramatic. By 2005, the agreement would slash tariffs on vehicles from between eighty to 100 percent to twenty-five percent. The cuts would be phased in equally each year. Tariffs on auto parts would decrease to an average of ten percent. The PRC agreed to join in various zero-tariff arrangements, and re-affirmed its commitment to participate in the Information Technology Agreement ("ITA"). As a result of the ITA, its tariffs on semi-conductors would fall from an average of 13.3 percent to zero.

- *NTBs.* All import quotas, including those for agricultural products and vehicles, would be phased out by 2005.

- *Distribution rights.* The restrictions on distribution (which the PRC acknowledged to be a service and thus governed by WTO disciplines, specifically, the GATS) would be phased out within three years. For sensitive sectors like chemical fertilizers, crude oil, and petroleum products, the phase-out period would be five years. Thus, foreign companies would be allowed to import, export, and distribute their goods within the PRC. They would do so by forming JVs with local trading companies. Including processed petroleum products (e.g., gasoline) in the offer to allow foreign companies distribution rights was significant, because the PRC's oil industry was heavily protected, and arguably strategic.

- *SOEs.* Purchases and sales of goods and services by SOEs would not be regarded as government procurement. Therefore, they would be covered by GATT-WTO rules. (Otherwise, they would be wholly exempt from GATT-WTO disciplines unless and until the

PRC joined the Uruguay Round plurilateral Agreement on Government Procurement. Even then, the Agreement - which only about twenty-five WTO Members have joined - is riddled with exceptions and exemptions.)

- *Intellectual Property Rights.* All government agencies would be directed to use only licensed software, and would have to scale back requirements for foreign companies to transfer technology in return for the right to invest in the PRC.

- *Financial services.* Foreign banks would be allowed to engage in all forms of foreign currency business with foreign clients as soon as the PRC entered the WTO, and with Chinese clients one year thereafter. Foreign banks would be able to engage in all types of local currency business with Chinese companies within two years of accession, and with individual Chinese account holders within five years of accession. All geographic restrictions would be phased out over five years. In addition, insurance companies could engage in more types of business.

- *Telecommunications.* The general prohibition against foreign investment in the Chinese telecom industry would be eliminated. Foreign telecom providers would have improved market access by allowing them to take an equity interest of up to forty-nine percent in any Chinese telecom company within four years. For paging services and value-added services (e.g., network and information services), foreign companies would be allowed to hold a controlling fifty-one percent stake in Chinese telecom companies. The geographic restriction that limits foreign telecom companies to Shanghai and Guangzhou would be phased out, and the Beijing - Shanghai - Guangzhou corridor would be open for FDI immediately. In addition, the PRC agreed to adopt the American cellular phone standard (CDMA, for "code division multiple access"), not the European standard (known as GSM).

- *Agriculture.* Average tariff rates on agricultural products would drop to seventeen percent by 2004. For products considered a priority by the United States, the average would fall to 14.5 percent by 2004. Tariffs on soybeans, a key American export, would fall to three percent immediately, and tariffs on beef, another important American export, would fall to twelve percent by 2004. Tariffs on citrus fruit would fall from forty to twelve percent, and tariffs on

wine would fall from sixty-five to twenty percent. For bulk commodities, like barley, corn, cotton, soybean oil, rice, and wheat, the PRC would use a tariff-rate quota. A minimal tariff of one to three percent would be charged on below-quota imports, and a high tariff would be imposed on over-quota shipments. The quotas would be set well in excess of current import levels, so the high tariff usually would not be relevant.

- *SPS measures.* Unjustified SPS measures would be terminated. For example, the PRC agreed to end its long-standing ban on wheat from the Pacific northwest. It had imposed the ban in 1979 because the wheat contained a plant fungal disease, TCK smut, but the United States maintained there was no scientific justification for concern. The PRC agreed to a higher tolerance level for the fungus so as to allow most American-grown wheat. (In February 2000, the PRC formally ended the ban and made a symbolic purchase of 50,000 metric tons of wheat, worth \$6 million.) As another example, the PRC would drop the requirement that American meat-packing plants exporting to the PRC undergo inspections by PRC officials. Finally, an SPS ban on citrus would be lifted.

- *Cultural industries.* The rule barring foreign companies from owning and operating Chinese cinemas would be eliminated, and FDI in this sector would be allowed.

To the USTR, the economic and foreign policy interests of the United States were satisfied. All trade hands expected an imminent dramatic - and positive - announcement. None was made. In both countries, domestic political considerations overwhelmed economic and foreign policy interests. In the United States, President Clinton's standing in Congress had been weakened badly by two scandals: alleged illegal Chinese campaign contributions, and his involvement with Monica Lewinsky, a situation which led ultimately to his impeachment by the House of Representatives. Now, a third scandal erupted: apparent thefts of nuclear weapons technology by the PRC. In the spring and summer of 1999, the Clinton Administration was accused of negligence in enforcing security at United States' nuclear weapons laboratories, and of lax export controls. A lengthy congressional report, released by Rep. Christopher Cox (R-Ca.) on May 25, did more than merely recount the lapses. It concluded that the PRC had succeeded in stealing secrets, enabling them to make and deploy

far more accurate, long-range strategic weapons such as the W88 Trident ballistic missile warhead. WTO accession negotiations became politicized and diminished in importance. Any deal would have to provide the President political cover from the vocal anti-China lobby, a strange collection of bed fellows: environmental, labor, human rights, religious, and consumer organizations, plus unreconstructed hard-line Cold Warriors.

The essence of the problem was that if the United States were to reach a bilateral concession agreement with the PRC and thereby pave the way to WTO accession for China, then President Clinton would need Congressional support in three ways. First, there was sure to be a resolution disapproving of the deal, and the President would need forces in Congress to defeat it. To be sure, Congress had never voted on GATT or WTO membership of another country before, but they saw the PRC case differently. As early as 1997, House Minority Leader Richard Gephardt proposed legislation giving Congress the right to veto any bilateral concession agreement. In early 1999, Senator Tim Hutchinson of Arkansas sponsored a bill requiring a joint Senate-House resolution before a WTO deal with the PRC could enter into force. Several other legislators had made similar proposals, and all had failed. Yet, more efforts surely would be made once the President accepted an offer from the PRC.

Second, the President would have to persuade Congress to grant the PRC permanent MFN treatment, thereby exempting it from the annual waiver process conducted under the Jackson-Vanik Amendment. Third, the President would have to satisfy, or modify, the terms of a rather obscure provision of the 1988 Act concerning SOEs. Essentially, that provision would suspend the application of the Uruguay Round agreements by the United States to the PRC because of its SOEs, unless and until certain stringent conditions were satisfied.

The USTR, backed by the State Department and National Security Council, pressed the President to accept the deal. Top Clinton aides, Chief of Staff John Podesta, and Gene Sperling, head of the National Economic Council, backed by the Treasury Department, worried that if the President did not hold out for more concessions, the deal might not be attractive enough to overcome Congressional opposition. The latter group won. Even if it were in the United States' economic and

foreign policy interests to accept Premier Zhu's new concessions, the President simply lacked the political clout in Congress to carry through on the existing offer.

Thus, the President backed away, arguing more concessions from the PRC were needed. The two sides vowed to restart the negotiations and complete a bilateral agreement by the end of 1999. Still, the Chinese Premier left without an agreement, causing him considerable loss of face at home. That embarrassment was one example of a foreign policy interest compromised in favor of domestic political considerations. Zhu was an energetic, pro-western reformer, and his diminished standing with hard-line, protectionist, or militaristic officials in his government was not good for the United States.

In the PRC, Premier Zhu's standing clearly had been hurt. Many of the concessions offered by the Premier drew fierce criticism. As one department head at an industrial ministry in Beijing said: "The Premier offered the Americans far too much. It is absurd. What is he trying to do? Bankrupt everyone?" Xie Yutang, the mayor of Jihan (capital of the northern province of Shandong), argued that every one percentage point reduction in tariffs would lead to a five percentage point increase in the market share of foreign goods. He bristled at Zhu's offer to reduce vehicle import tariffs. Without protection, Jihan's National Heavy Truck Corporation, a large local employer, would be destroyed. Still other senior Chinese officials went so far as to accuse Zhu of betraying the country.

Certainly, part of the blame lay with the Premier, since he had neglected to get approval from all of the relevant ministries in Beijing before offering to make the concessions. However, the USTR had compounded Zhu's difficulties. On April 8, with negotiations still underway, and without consulting the Chinese, the USTR claimed to chronicle Zhu's offer in a seventeen page document, entitled "Market Access and Protocol Commitments." Released over the internet, the document caught Zhu off guard and enraged Chinese trade negotiators.

Subsequently, during April and May, the Chinese government quickly backpedaled. It disavowed the document, claiming it had never made many of the alleged promises. The PRC had not, for instance, agreed to importation and distribution rights for American oil companies. All foreign companies operating gas stations in the PRC

would still have to buy their gasoline from one of three SOEs that control all importation rights. The PRC also withdrew some of its concessions. For instance, it stated its desire to protect its domestic car industry for eight years after WTO accession. On banking, insurance, telecommunications and FDI, the PRC either diluted or withdrew its offers. For example, the PRC claimed it would not allow foreign companies to hold a controlling stake in Chinese telecommunication firms for "information security reasons."

As a result, pro-reform, pro-liberalization forces in Beijing, led by MOFTEC, were forced to walk a tightrope. On the one hand, they had to convince officials throughout the PRC, particularly in SOEs and their ministries, at the provincial level, and in rural areas, that Premier Zhu had not offered traitorous concessions. They had to argue again that WTO accession would be a net benefit for the PRC. On the other hand, they had to yield to the United States just enough to secure a bilateral agreement. For a while, this balancing act seemed to work. On April 27, He Yafei, the Minister-Counselor at the PRC's embassy in Washington, optimistically opined that "[t]he deal is 99% done." However, shortly thereafter, the tightrope snapped for reasons having nothing to do with trade.

On May 7, in the midst of the Kosovo conflict, a NATO warplane, with an American pilot, bombed the PRC's embassy in Belgrade, causing severe damage, and killing three Chinese journalists and injuring twenty-seven civilians. Since news of the incident first came over the internet, not the official media, Chinese censors had no chance to "package" the information. Thousands of Chinese - led initially by students with internet access - took to the streets in Beijing, attacking the United States Embassy, throwing stones, and burning the American flag. The scene played out on television, reminding America of the takeover of its embassy in Tehran twenty years earlier.

The disturbances were not limited to Beijing. In Chengdu, rowdy civilians burned the residence of the American Consulate General. At Fudan University in Shanghai, when an American professor walked in the classroom, a Chinese student stood up and shouted "I hate Americans and I have nothing to learn from you!" In Xian, the Hyatt hotel also attracted public protests. Throughout China cinemas suspended screenings of American movies and China Central Television

withdrew advertisements for American goods.

The violent explosion unsettled the Chinese government. It delayed broadcasting President Clinton's apology for the bombing for two days. Worried about losing control of the volatile situation, the government reversed course, restoring order, and taking pains to assure American investors that China was still open for business - and tourism. The government also took into account its fifty-five racial minorities: to condone further nationalistic demonstrations risked alienating them.

Naturally, the destruction of its Belgrade Embassy outraged the Chinese government. It suspended WTO accession negotiations until the United States fulfilled four conditions: 1) apologize for the bombing; 2) prosecute those responsible; 3) pay compensation for the loss of life and for destruction of the building; and 4) provide a thorough explanation for the bombing. President Clinton promptly apologized, the Central Intelligence Agency eventually dismissed one mid-level official and disciplined six others, although Beijing appeared unimpressed at the lack of severity of the action. Regarding the third condition, President Clinton prepared to negotiate. Initially, the United States paid \$4.5 million to the families of those killed and injured in the bombing and agreed to a further \$28 million compensatory payment for property damage. (Conversely, the PRC covered the \$2.87 million cost of damages to the American Embassy in Beijing). As to the fourth condition, owing to a lengthy internal investigation, over one month passed before Clinton could send a special emissary to Beijing. On June 16, Undersecretary of State Thomas Pickering, delivered a one-word explanation: accident. The formal explanation finally arrived in April 2000, unchanged. The pilot had been guided by outdated Yugoslav and CIA maps, showing the embassy at its previous address; Pentagon data bases had not been updated with the embassy's most recent location, and the target review system had failed to spot the error. Furthermore, the plane actually had targeted the Yugoslav military supply headquarters a few hundred yards from the embassy. The PRC publicly rejected Pickering's explanation as "unconvincing and unacceptable," and the *People's Daily* lampooned it as a "tale for the Arabian nights." Privately, PRC officials appeared persuaded that no senior United States government official had ordered the attack on their embassy. Nevertheless many remained deeply suspicious that the United States could commit so

grievous an intelligence error. Perhaps, they thought, "rogue" elements in the CIA or Pentagon had somehow managed to carry out the bombing.

Because of this situation, an agreement on WTO accession was farther away than ever before. To make matters worse, the very division among the ranks feared by American trade negotiators materialized. In July 1999, Japan signed a bilateral agreement with the PRC, backing down on tough conditions for telecommunications market access. Moreover, during the summer, tensions between the PRC and Taiwan when Taiwan's President, Lee Tung Hui, characterized relations between the two countries as "state-to-state." Once again, the PRC unleashed menacing military maneuvers and heated rhetoric. Privately the United States assured Taiwan of military assistance, and stepped up weapons sales to the island. They did not rule out including Taiwan in the proposed Theater Missile Defense (TMD) system, a regional shield to protect Japan, Korea, and other countries. That the saber-rattling did not crescendo with a war remained the only bright spot.

G. THE FINAL PUSH FOR A BILATERAL AGREEMENT WITH THE UNITED STATES: FALL 1999

Fortunately, by the late summer of 1999, much of the domestic opposition in the PRC to WTO accession apparently abated. On September 2, the two sides agreed to resume talks about WTO accession. Why the shift? Perhaps Premier Zhu and his allies hoped to quash opposition to their reform plans through WTO accession. Joining the WTO meant exposing SOEs and their protective ministries to foreign competition thereby weakening them. Another answer is that President Jiang wanted accession, as well as a close, strategic partnership with the United States, to define the legacy of his tenure in office. In any case, time was running out.

A less cynical answer may be that the PRC stared into a bleak future: if no deal was done soon, no deal would get done for several years. Like Taiwan, the PRC may have understood that if it did not accede before the scheduled start of a new WTO negotiating round, the Millennium Round, the "ante" would increase as a result of that round's new trade liberalization agreements. As a related issue, the PRC hoped that the 2000 American presidential campaign would not

further entangle the issue, with both candidates calling for tougher and tougher negotiations with the PRC.

The success of the marketing campaign by the pro-reform, pro-liberalization officials provides one of the most plausible reasons for the shift. The PRC's State Development Planning Commission ("SDPC"), which is responsible for overseeing economic reforms and the restructuring of SOEs, harbored strong reservations about joining the WTO. In early September, however, an SDPC vice-minister, Wang Chunzheng, declared that the advantages of WTO membership would outweigh the disadvantages. Later that month, the SDPC Chairman, Zeng Peiyan, reaffirmed the PRC's commitment to lower trade barriers and increased market access in service sectors, especially banking, accounting, law, aviation, tourism, retailing and wholesaling. The finance minister, Xiang Huaicheng, added that lowering tariffs would not cause a budgetary strain because larger import volumes—attributable in part to a reduced incentive to smuggle—would offset the lower rate. In brief, on the merits, the PRC seemed to sense its vital domestic interests lay on the side of accession, which would lead to greater market access for Chinese exports overseas and to increased flows of foreign capital into the PRC. Both results would bolster the PRC's economy and reform efforts.

This forecast received support from an unexpected quarter: the International Trade Commission ("ITC"). In fall 1999, the ITC published its *Assessment of the Economic Effects on the United States of China's Accession to the WTO* (Inv. No. 332-403, Publications 3228 and 3229). The ITC considered the overall impact of accession based on the tariff and NTB cuts Premier Zhu had offered in April. The effects on the American economy would be negligible, although the bilateral trade deficit with the PRC would expand. This is because while American exports of beverages, corn, cotton, machinery, tobacco, and vegetable oils would rise, Chinese exports of textiles, apparel, and other products would also grow dramatically. The ITC also reported the PRC would benefit from the liberalization associated with WTO accession, in the form of significant growth effects.

The USTR maintained that the talks on a bilateral concession agreement ought to begin where the negotiations had left off in April - with Premier's Zhu's concessions. That meant the same range of

issues remained on the table and the United States had some new concerns in certain areas. For example:

- *Tariffs*. The United States remained concerned about tariff spikes affecting industrial equipment.
- *Safeguards*. The United States wanted special rules to combat anticipated import surges, following PRC accession. The PRC agreed that simple market disruption criteria, based on an existing federal statute applicable to non-market economies, rather than the more stringent escape clause standards that require a showing of injury or threat of injury (set forth in Section 201 of the 1974 Act) could trigger a safeguard action. The two sides could not agree on how long the special rules would apply.
- *Antidumping* (“AD”). The United States advocated special rules to combat alleged dumping of Chinese steel. The rules would make Chinese steel imports more susceptible to AD actions than steel from other WTO Members.
- *FDI*. The United States found the phase-in periods for some of the PRC’s commitments on investment to be too long. Moreover, the PRC’s concessions on FDI were less valuable now, because the “China market” had soured. During the 1990s, China’s annual increase in FDI averaged over forty percent, peaking in 1993 at a staggering 175 percent. It seemed as though Ford Motor Company Chairman Alex Troutman spoke for many CEO’s when he said, “I can’t go down in history as the Ford chairman who missed China.” But, in 1999, for the first time in two decades, Foreign Direct Investment fell. Multinational Corporations (“MNCs”) that were interested in tapping China’s pool of cheap labor, selling to Chinese consumers, or supplying factories of other foreign investors, now lost sizeable sums. Of China’s 1.3 billion people, only twenty to thirty million on the east coast could afford foreign brands. Furthermore, the distribution network remained poor, easily moving goods from China’s interior to exporting port cities, but failing to channel imported goods into the far reaches of the country. Government bureaucracy remained a serious barrier to obtaining necessary approvals, even for minor operations. Thus, the PRC would have to offer significantly larger number of concessions aimed at improving the investment climate.
- *Telecommunications*. The United States insisted that China

permit foreign telecommunications companies to own up to a fifty-one percent stake in Chinese telecom service providers.

- *Financial and other services.* The United States insisted on improved market access offers for banking, automobile financing, and insurance. A foreign insurer could not apply for an operating license, unless it had maintained a representative office in the PRC for at least two years. Once granted, a license restricted operation to Shanghai and Guangzhou and required the foreign insurer to join with a Chinese joint venture partner. Worse yet, PRC authorities insisted on picking such partners for foreign life insurers. In addition, the United States argued that foreign insurers ought to be able to sell all products, including group insurance, health, and pension policies. These three areas represented eighty-five percent of the total premium income in the PRC. However, such policies confined foreign insurers to selling individual life policies. In addition, foreign insurers should be able to sell their products to all customers. While property and casualty insurers could open branch offices, they could deal only with foreign-owned or joint venture companies. The United States also sought improvements on the PRC's offer concerning foreign banks, securities firms, and professional services.

- *Textiles.* The two sides had yet to agree on a schedule for phasing out American quotas on Chinese textiles. Under intense pressure from the American Textile Manufacturers Institute ("ATMI"), and mindful of the need to secure support from members of Congress from textile states, the USTR pressed for a ten-year phase out period, lasting until 2010, five years longer than provided for under the Uruguay Round Agreement on Textiles and Clothing ("ATC"). The ATC eliminated quotas on textiles from all other WTO Members as of 2005. With the PRC as the world's largest single country exporter of textile and apparel products, the ATMI estimated that granting the PRC a quota phase-out in 2005, rather than 2010, would result in the loss of 154,500 American jobs, \$4 billion in textile sales, and \$7.6 billion in apparel sales. However, the PRC wanted the American textile quotas phased out according to the standard five year schedule.

- *Cultural industries.* The United States sought an improved offer for audiovisual services. The PRC had an unofficial limit of allowing just ten American films to be shown in the country each year,

which state-owned distributors bought for a flat fee. The Motion Picture Association of America lobbied for an increase in 1999 to seventeen; and an increase by 2000 to twenty-five.

In addition to these reservations, some matters from 1996-98 remained at issue while a few new incarnations of old problems also appeared. After all, as Representative Sander M. Levin (D-Mich.) said, "in deciding whether to support an agreement [on accession], most members of Congress will ask themselves: 'How will it affect the living standards of my constituents and the American people?'" For Congress to answer positively, the PRC would need to address the majority of American demands.

Negotiations began in earnest in September 1999, following meetings between American and Chinese officials, including the two Presidents, at the APEC summit in Auckland. Significantly, however, the Chinese continued to disavow some of the sweeping concessions Premier Zhu had made in April.

This was not necessarily the starting point that the USTR wanted, but the Embassy bombing had clearly weakened China's domestic position, rendering it incapable of dramatic concessions. Moreover, Premier Zhu himself no longer controlled the negotiations. Having both lost face and incurred the wrath of many PRC bureaucrats after the April debacle, he had to cede leadership on many economic issues to President Jiang. Thus, Shi Guangsheng, the Minister of MOFTEC (*i.e.*, the PRC's counterpart to the USTR), said that "the views of our two sides are very different," and that with respect to the infamous list the USTR published in April: "[w]ithin the list there are some items that China has committed itself to. But many are things that China has not agreed to and will not agree to in the future." In other words, this offer qualified as nothing more than an American wish list. The Minister even resurrected an old demand: developing country status. As Foreign Ministry Spokesman Sun Yuxi said, "China, as a universally recognized developing country, will not accept any condition that goes beyond the economic capacity of China, and will not undermine its national interests."

Perhaps, in truth, the PRC had lost some enthusiasm for WTO accession, as Chinese leaders sent mixed signals. At the APEC summit, President Jiang reiterated a pledge, initially made in 1996-97, to lower industrial tariffs to fifteen percent by 2000, adding that the

PRC would drop them to ten percent before 2005. He assured the United States of the PRC's continuing commitment to opening its economy to FDI, allowing foreign banks to conduct local currency business and start JV trading firms, and combating IPR piracy. However, Wu Jichuan, Minister of Information Industries, a conservative rival of Premier Zhu, declared his opposition to allowing foreign entry into the PRC's telecommunications and internet services markets unless WTO members forced this concession upon the PRC.

That statement, followed in late October by an announcement that the PRC would prohibit new foreign investment in the internet, was potentially bad news for several American internet companies: America Online, which owns a stake of China.com (a Chinese portal), for Dow Jones and Intel, which have part ownership of Sohu.com (a Chinese internet company), and for all other foreign companies eagerly eyeing the rapidly growing telecom and internet market in the PRC. The forced unwinding of more than \$1.4 billion in foreign investment through joint ventures with Unicom, a Chinese state-owned telecommunications carrier was equally bad. Yet, Mr. Wu had good reason for his position. He feared foreign telecom companies would seek entry only into the most lucrative business markets in the Beijing - Shanghai - Guangzhou corridor, dumping the responsibility of providing services to less profitable areas, such as north-west China, on the government.

Still, the accession negotiations continued throughout the fall of 1999 amidst an atmosphere of cautious optimism, occasional doubt, and regret that the Clinton Administration had walked away from the April deal. In early October, the PRC announced it would open more cities to foreign insurance companies, and issue more licenses to overseas ventures. The crucial questions of "when?" and "how many?" remained unanswered. Later that month, during a trip to the PRC by Treasury Secretary Lawrence Summers, the two sides reaffirmed their shared commitment to Chinese accession "at the earliest possible date." In early November, President Clinton telephoned President Jiang and dispatched Ambassador Barshefsky to Beijing to try and work out a deal with Minister Guangsheng before the Seattle WTO Ministerial Conference, scheduled for November 30-December 3. Almost simultaneously, telecommunications, a key sector, provided a setback. The PRC's Ministry of Information Industries announced plans to impose production quotas and import re-

restrictions on foreign manufacturers of mobile phone handsets in order to help nine fledgling domestic companies. The foreign companies—principally Ericsson (Sweden), Motorola (United States), and Nokia (Finland)—controlled about eighty-five percent of China's market, the world's fastest growing market for mobile phones. The Ministry said it would strive to ensure domestic companies gained a fifty percent share of the local handset market by allocating production quotas to foreign and local manufacturers after negotiation. Each company would receive a number of government-issued seals equal to its production quota, and every mobile phone it sold would have to bear the official seal.

II. THE BILATERAL AGREEMENT OF NOVEMBER 15, 1999

Amidst the roller coaster of expectations and emotions, House Majority Leader Richard Armey (R-Tex.) was a leading voice in the rising chorus urging a rapid and successful conclusion: "History has proven time and again that expanded trade is a crucial tool in expanding democracy and undermining tyranny We must look to expanded trade as a significant opportunity to build greater understanding and encouragement of freedom and democracy among the people of mainland China." Far more was at stake than market access for foreign firms or the need to bolster the process of market-transition reform in the PRC.

Perhaps this grander vision of the stakes propelled the two sides, to a final deal, on November 15, 1999. Or, perhaps a shared personal demon motivated Presidents Jiang and Clinton: securing their mutual places in history. President Jiang, in contrast to Deng Xiaoping and his open-door policy, had no great defining moment to his tenure. President Clinton, in the words of the *Financial Times*, "is desperately trying to forge a historical legacy that goes beyond sex scandals," and to "bury the memory" of one of his most serious foreign policy errors, namely, turning down the April offer from Premier Zhu.

Whatever the impetus, following several days of tense negotiations in Beijing between Ambassador Barshefsky and Premier Zhu and Minister Guangsheng, the United States and the PRC signed an

historic bilateral agreement paving the way for Chinese accession to the WTO. The key points of the deal, detailed in 250 pages of text, were as follows:

- *Tariffs.* The PRC agreed to reduce overall tariffs from an average of 22.1 percent to an average of seventeen percent. It promised to slash tariffs on industrial goods from the 1997 average of 24.6 percent to 9.4 percent by 2005, with the majority of cuts by 2003. Regarding industrial products considered by the United States to be a priority (*i.e.*, in which the United States has a keen export interest), the PRC agreed to reduce tariffs to 7.1 percent. The PRC also agreed to participate in the ITA; thereby committing itself to reducing tariffs on computers, computer equipment, semiconductors, and internet-related equipment from 13.3 percent to zero by 2005.
- *Quotas.* The PRC agreed to eliminate all import quotas on industrial goods by 2005, with most quotas abolished by 2002. For priority American products (*e.g.*, optic fiber cable), the PRC agreed it would eliminate quotas immediately upon accession. While still in operation, quotas will grow at an annual rate of fifteen percent to ensure that market access increases progressively.
- *Agriculture.* The PRC agreed to reduce the overall agricultural tariffs to seventeen percent by January 2004. This reduction was considerable, as the PRC's tariffs on farm goods ranged from twenty to fifty percent, with an average rate of 31.5 percent. Moreover, on agricultural products the United States considers a priority, the PRC agreed to cut tariffs by January 2004 from an average of 31.5 percent to an average of 14.5 percent. These products include beef (with a pre-agreement rate of forty-five percent and a post-agreement rate of twelve percent), cheese (fifty percent and twelve percent), poultry (twenty percent and ten percent), and wine (sixty-five percent and twelve percent). The PRC also agreed to liberalize purchases of bulk agricultural commodities by establishing tariff-rate quotas ("TRQs") for barley, corn, cotton, rice, and wheat, and phasing out state trading of soy oil. The quota thresholds in these TRQs will be high and the applicable tariff for over-quota shipments will average between one and three percent. Private traders are reserved a share of the TRQs (On some items, such as cottonseed oil, peanut oil, soybean oil, and sunflower-seed oil, the PRC agreed to an immediate elimination of TRQs.) More generally, for the first time, the PRC agreed to permit

trade in agricultural goods between private parties. Finally, the PRC pledged to eliminate SPS measures not based on scientific evidence.

- *Automobiles.* The PRC agreed to reduce tariffs on vehicles from eighty to 100 percent to twenty-five percent by July 1, 2006, and to make the deepest cuts within the first few years following accession. It pledged to cut tariffs on auto parts by the same date to an average of ten percent. The United States hoped for a phase-out period that would end by 2005; however, it agreed to the extra year in exchange for a Chinese pledge to allow foreign non-bank financial institutions to provide automobile financing immediately upon accession. In addition, the PRC agreed to phase out all quotas on auto imports by 2005. Until then, it is committed to a base level quota of \$6 billion, and to increasing this level by fifteen percent annually until the quotas are eliminated.

- *Trading rights.* The PRC agreed to grant foreign firms full rights to import and export goods, with no need to trade through a Chinese middleman. The PRC said it would phase these rights in over three years.

- *Distribution rights.* The PRC agreed to grant distribution rights to foreign exporters and manufacturers for both agricultural and industrial goods, whether imported or made in the PRC, within three years following accession. The foreign firms will be able to conduct their own distribution networks, again without Chinese middlemen. They will be able to maintain wholesale or retail operations, as well as after-sales services (e.g., repair, maintenance, and transport). However, the PRC maintained some limitations on distribution rights. For example, in the first three years after accession, foreign oil companies are limited to thirty gas service stations in the country, thus inhibiting the distribution of their product.

- *Services auxiliary to distribution.* The PRC agreed to phase out all restrictions on services auxiliary to distribution within three to four years following accession. Examples of these services include freight forwarding, packing, rental and leasing, storage and warehousing, and technical testing and analysis. After the phase-out period, the PRC promised that foreign firms might establish 100 percent wholly owned subsidiaries to provide these services.

- *Textiles.* The United States agreed to phase out textile quotas which the Uruguay Round ATC calls for by 2005 (corresponding to

the expiration of the MFA), even though the domestic United States textile lobby hoped for 2010. However, after the PRC's accession, the United States will retain a special safeguard mechanism aimed at preventing textile import surcharges for the next twelve years for twelve years (*i.e.*, until December 31, 2008, which is after the Uruguay Round ATC expires). The United States created this remedy especially for use against a rapid increase in Chinese textile imports that cause, or threaten to cause, market disruption—namely, material injury—in the United States.

- *Dumping.* For purposes of monitoring the possible dumping of Chinese goods, the United States will continue to treat the PRC as a non-market economy for fifteen years after it accedes. Accordingly, when calculating Normal Value (“NV”) in the computation of the dumping margin (the difference between NV and Export Price (“EP”) or Constructed Export Price (“CEP”)), the Department of Commerce (“DOC”) is likely to use a proxy, CV. To arrive at a value for CV, the DOC will look to data from a third country, such as India, Indonesia, or Thailand or even Paraguay, as occurred in the past. Respondents in AD cases argue this calculation—in particular, the choice of a third country from which to gather data for CV—is highly arbitrary and skewed toward finding a positive dumping margin. The USTR noted that the non-market economy (“NME”) statute is self-limiting; if a particular sector in a foreign economy, or an entire foreign economy, demonstrates it has become market-oriented, then the rules are not applied to that sector.

- *Subsidies.* The PRC agreed to eliminate all export subsidies. The elimination of these subsidies on cotton and rice was of particular importance to the United States. In addition, the United States reserved the right for the fifteen years following the PRC's accession to consider the special characteristics of the PRC's economy when applying countervailing duty (“CVD”) law. In particular, in a case involving a newly privatized company, the United States could identify and measure the benefit of a subsidy provided to that firm when it was still an SOE, and thereby fashion an argument that the benefit carried through to the post-privatization entity. Finally, the PRC accepted the ability of foreign governments to apply the Uruguay Round SCM Agreement against Chinese SOEs, when appropriate.

- *Product-Specific Safeguard.* In addition to the normal WTO

safeguard mechanism pursuant to GATT Article XIX and the Uruguay Round Agreement on Safeguards, American firms are permitted to avail themselves of a new and special safeguard remedy, known as the Product-Specific Safeguard. This remedy addresses imports of Chinese goods that are a significant cause, or threat, of material injury to a United States industry. The remedy differs from a normal safeguard action in two key respects. First, the United States will be allowed to apply import restraints unilaterally based on criteria that are less stringent than in the Agreement on Safeguards. Second, it permits the PRC to address import surcharges by imposing voluntary restraint agreements ("VRAs"), which are otherwise illegal under Article 11:1(b) of the Agreement on Safeguards. The Product-Specific Safeguard will remain in force for twelve years following the PRC's accession to the WTO.

- *Telecommunications.* The PRC agreed to open, within limits, its telecom market to foreign companies and provide them with national treatment. Through these commitments, the PRC agreed to join the WTO Basic Telecommunications Agreement. Consequently, the PRC agreed to implement the pro-competitive regulatory principles set forth in the Agreement, like cost-based pricing, interconnection rights, the establishment of an independent regulatory authority, and technologically-neutral scheduling (*i.e.*, allowing foreign suppliers to choose which technology to use in providing telecom services). As for the market-opening commitments made by the PRC, they covered two broad areas: FDI in the telecom sector, and geographic restrictions on the provision of telecom services. With respect to FDI, the PRC agreed, effective immediately upon accession, to allow foreign companies to take up to a forty-nine percent stake in JVs engaged in certain telecom services. After two years of membership, they would be permitted a fifty percent stake in JVs providing value-added and paging services. After five years, foreign firms could take up to a forty-nine percent stake in JVs providing mobile voice and data services. After six years, they could own up to forty-nine percent of a JV providing domestic and international services. Thus, the United States dropped its insistence that the PRC allow foreign firms a fifty-one percent equity interest within four or five years after accession. In return, the United States accepted immediate forty-nine percent stakes, rising to fifty percent stakes with management control within two years. The USTR pointed out that under

Chinese law, contractual management and operational participation was possible with a fifty/fifty ownership structure. Regarding geographic limitations on the provision of telecom services by foreign firms, the PRC agreed to phase out all such restrictions for paging, value added, and closed user groups in three years, mobile, cellular, and data services in five years, and domestic wireline and international services in six years. The PRC agreed to open its most important telecom corridor—the Beijing - Shanghai - Guangzhou region, which represents seventy-five percent of all traffic in the PRC—immediately upon accession to all telecom services. The PRC also assured the United States it would permit foreign firms to provide telecom services via satellite. Finally, PRC authorities accepted the fact that production quotas on mobile phones they had planned would be incongruous with GATT-WTO rules, hence they abandoned the planned quotas.

- *Internet services.* Foreign companies may invest in Chinese Internet content providers, subject to a forty-nine percent equity limit. Whether existing foreign investments in excess of this limit would be “grandfathered” was not clear, though arguably such investments fall within the scope of a clause providing for the continuation of existing JVs in all service sectors.

- *Banking.* Two years after the PRC enters the WTO, foreign banks may conduct local currency business - deposit taking and lending - with Chinese enterprises in specified geographical regions. In other words, two years after accession, foreign banks will receive qualified national treatment within those regions. Five years after the accession, the PRC will lift customer and geographic restrictions, and foreign banks will be able to conduct retail business (principally taking deposits from, and making loans to, Chinese individuals) in local currency and will be able to establish branches anywhere in the PRC.

- *Securities underwriting.* The PRC agreed to permit foreign brokerage firms to operate in the PRC, subject to fairly tight restrictions. Foreign firms who want to investment in Chinese securities underwriting companies would have use a joint venture, and the foreign stake would be limited to thirty-three percent. The JVs would receive national treatment in order to underwrite domestic equity offerings. In addition, they could underwrite and trade in international

equity and all corporate and government debt issues. More generally, the PRC pledged that as the scope of business activities of Chinese securities firms grows, there will be a concomitant expansion in the permissible scope for foreign joint venture securities companies.

- *Fund management.* The PRC agreed to permit foreign fund managers to operate there, also subject to fairly tight restrictions. Foreign investment in JV fund management companies will be limited to thirty-three percent upon the PRC's accession. Three years following accession, the limit will rise to forty-nine percent. Thus, over time, foreign financial firms will receive national treatment, and experience an expansion in the scope of business concomitant with Chinese firms.

- *Insurance services.* The PRC agreed to award licenses to foreign insurance companies to do business in the PRC solely on the basis of prudential criteria. The PRC pledged to abandon economic needs tests (*i.e.*, conditioning the grant of a license on the economic needs of the locality in which the foreign firm proposes to do business), and to eliminate quantitative restrictions on the number of licenses it issued. With respect to FDI in specific insurance activities, the PRC agreed to grant foreign insurers the right—effective immediately upon WTO accession—to take up to a fifty percent equity stake in local life insurance companies, up to a fifty-one percent stake in non-life insurance companies, and up to 100 percent in re-insurance companies. (Non-life insurance products include health, pension, and property policies). These JVs are now empowered to insure large-scale risks, and foreign life insurance firms may pick their own JV partners. However, their operations would be restricted to key Chinese cities of priority interest to the United States during the first two-to-three years following accession, namely, a dozen cities including Shanghai and Guangzhou. Two years after accession, the PRC pledged it would open up a twelve more cities, including Beijing, and permit foreign non-life and re-insurance companies to form wholly owned subsidiaries. Five years after accession, the PRC would drop all geographic restrictions on licensing, and permit nation-wide branching. Regarding the scope of activities, the PRC agreed to allow foreign property and casualty firms to insure large-scale commercial risks nation-wide immediately upon accession. During a five year phase-in period, the PRC promised to expand the scope of permissible activities of foreign insurance companies to in-

clude group, health, and pension products. However, whether foreign insurers could offer group plans to companies not based in the same city as the insurer, and whether these insurers could open branch offices, is still unclear. Significantly, the PRC made no commitments on market access for foreign insurance brokers.

- *Cultural industries.* The PRC agreed to allow more foreign movie companies to increase distribution significantly than the pre-agreement limit of ten movies per year: forty in the first year following accession, and fifty by the third year. However, of these films, the PRC agree to distribute only twenty on a revenue-sharing basis. They also agreed to allow foreign companies to establish JVs to distribute audio and video recordings, and software entertainment, to own and operate cinemas, and to hold up to forty-nine percent of the shares of these JVs.

- *Travel and tourism.* The PRC pledged that—immediately upon accession—foreign-owned hotel companies could establish majority-owned hotels in the PRC, with no geographic restrictions on operations. Within three years following accession, they could set up 100 percent-owned hotels. In addition, the PRC agreed to allow foreign travel operators to provide the full range of travel agency services, and have access to government resorts.

- *Accounting services.* The PRC agreed to eliminate its mandatory localization requirement, thereby promising unrestricted access to individuals licensed in the PRC as certified public accountants (CPAs). It pledged to transparently award accounting licenses and to apply national treatment to foreign and Chinese applicants. Foreigners would retain majority control of accounting firms.

- *Legal services.* The PRC promised to allow foreigners majority control not only of accounting firms, but also of architectural, computer services, dental, engineering, management consulting, medical, and urban planning firms. Conversely, like many WTO Members, the PRC declined to allow foreigners to hold majority control in local legal practitioner firms.

The above list bespeaks the breathtaking nature of the negotiations—and of the PRC's concessions. A broader and deeper trade deal, with so many changes in the way the PRC interacts economically with the rest of the world, is scarcely imaginable. Yet, this was only part of the deal.

Upon accession, the PRC would assume all of the obligations in the GATT-WTO regime. For example, it would have to implement the TRIPS Agreement, and thereby eliminate trade and foreign exchange balancing requirements, and local content requirements. It would have to abandon the practice of conditioning investment approvals on performance requirements, offsets, and the conduct of R&D activities in the PRC. As another example, it would have to implement the TRIPS Agreement, and hence forswear forced technology transfer. Further still, the PRC would have to ensure that SOEs make purchases and sales based solely on commercial considerations (*e.g.*, price, quality, availability, and marketability), and provide foreign firms with the opportunity to compete for contracts on non-discriminatory terms. Significantly, the PRC agreed to the American demand that purchases and sales by SOEs would not be considered "government procurement" - and thus would be subject to normal GATT-WTO rules. (Were they considered government procurement, the PRC could avoid signing the Agreement on Government Procurement - a plurilateral arrangement - and thereby exempt its massive SOE sector).

China and Canada quickly followed the United States - PRC bilateral agreement was followed quickly with a similar accord. The deal between Washington and Beijing satisfied the Canadians, but they still had unique concerns. They sought improved market access for key agricultural exports; namely, barley and wheat. Canada wanted the PRC to improve its offer on tariffs and TRQs for these crops. The PRC apparently did so, and also offered better access (in the form of no minimum capital requirement) for Canadian small businesses involved in distribution services than was set forth in the agreement with the United States (which contained a capital requirement). Thus, on November 26, Canada and the PRC announced their accord.

A. CONTROVERSIES SURROUNDING THE NOVEMBER 15, 1999 BILATERAL AGREEMENT

One of the hotly debated issues that erupted immediately following the November 15 bilateral agreement was whether the package really differed from the concessions made by Premier Zhu in April. Both sides sought to preserve "face." The United States insisted it had gotten at least as good a deal, if not better. The PRC denied that the April deal had been the basis for the final agreement.

Corporate America, although generally supportive of the deal, still had some concerns. For example, in securities underwriting and fund management, the prospect of taking only a minority interest in a JV was not particularly attractive. Further, on the issue of corporate income taxes, the PRC announced in January 2000 that it would phase out preferential tax policies for foreign enterprises. The PRC implemented these preferences in the early 1990s to encourage FDI. Under then-existing tax law, all corporations faced a flat thirty-three percent annual income tax rate. But, the availability of various deductions meant foreign companies tended to pay much less. They also benefited from a two-year tax holiday, followed by from three years of income taxation at half rates. Foreign companies in special economic zones (*e.g.*, Shenzhen, Zhuhai, and Tianjin) got these benefits and more. Their corporate income tax was just fifteen percent, and local income taxes (normally around three percent) were waived. The PRC argued it would have to level the playing field to conform with the GATT Article III:1-2 national treatment obligation. In fact, nothing in Article III prevents a government from treating domestic production less favorably than foreign manufacturing.

Organized labor immediately condemned the deal as a “grave mistake,” and pledged to oppose it. The President of the AFL-CIO, John Sweeney, declared the WTO deal “disgustingly hypocritical,” and said that “by continuing to persecute dissenters, to imprison labor leaders and worker activists, and to export goods produced by slave labor, China shows no interest in playing even by the most basic rules of the world economy.” The Brussels-based International Confederation of Free Trade Unions (“ICFTU”) echoed these sentiments, reminding the PRC that during the 1996 Singapore Ministerial Conference, all WTO Members pledged to uphold internationally recognized core labor standards, and expected no less from the PRC.

Furthermore, the United States and PRC had differing opinions on the interpretation of certain key provisions of the deal. Insurance service was a prominent example. Ma Yongwei, Chairman of the China Insurance Regulatory Commission (“CIRC”), noted there were two “prudential criteria” under which the PRC could deny an operating license to a foreign insurer. First, the applicant must be financially strong. That would mean a firm would need \$30 billion in assets, a thirty-year history, and a representative office in the PRC for at least two years. This criterion is internationally recognized and,

therefore, not particularly controversial. His second criterion, however, was controversial. Yongwei asserted the PRC could deny a license application if approval threatened the stability of Chinese economic policy (specifically, monetary, credit, or financial policies). The United States feared the PRC might block an application for subjective reasons, such as whether local insurers could withstand foreign competition, or would manipulate the system to continue the tradition of granting licenses as political favors to different nations.

These concerns were not unfounded. The PRC's insurance industry was anemic, partly as a result of misguided regulation. Chinese insurers had no choice but to invest their premium income in bank deposits or treasury bonds. These investments earned interest rates below the rates the insurers had to pay most of their customers. Only in November 1999 did the Chinese government allow local insurers to invest in higher-yielding instruments, such as the stock market. Yet, the prospect of improved earnings did not significantly lessen the threat, as perceived by the PRC, that foreign competition might drive local insurers into insolvency. Hence, the United States' concerns about the PRC's potential for protectionist abuse of the second criterion.

More generally, the interpretive dispute raised familiar questions - could the PRC live up to a WTO bargain? Would it learn to behave by the rule of law, not only in the international trade arena, but also in its domestic setting by implementing profound changes in its legal system?

Another excellent example of post-bilateral deal squabbling concerned banking services. The deal did not place any local currency lending restrictions on foreign bank branches doing business in China. In March 2000, the People's Bank of China proposed a limit on lending in renminbi to four times (or sometimes eight times) the operating capital of the Chinese branch of a foreign bank. Significantly, the operating capital of that foreign bank branch's home office would not be eligible for consideration. Under China's existing rules, the operating capital of foreign bank branches had to be between thirty million and 300 million renminbi (approximately \$3-\$10 million).

These proposed rules were not entirely irrational. What if the loans made by a foreign bank branch went bad? If the branch did not have

adequate capital to absorb the loss resulting from the write-off of bad loans, then the People's Bank might be forced to help rescue the branch (say, for example, by extending credit). This is because if the branch collapsed, it would not be able to pay off its creditors on other transactions in which it had engaged. Systemic risk—a chain of bank failures—might set in, causing a broader public panic. Was this not precisely the fear of central banks worldwide in so many international banking problems, most notoriously the 1991 Bank of Credit and Commerce International (BCCI) crisis? To respond, foreign banks only needed to transfer more capital to their Chinese branches. Most had been keeping only the minimum of thirty million renminbi. The PRC had one other plausible argument: the proposed lending limits would apply equally to foreign and domestic banks. Therefore, there would be no violation of the national treatment provision of GATS Article XVI:1.

However, the problem with the Chinese position was how the People's Bank defined "adequate" capitalization, given that the November 15 bilateral deal had failed to spell this out. At what point does "adequate" become protectionist? After all, the smaller the pool of funds that a foreign bank branch can count as capital, and the lower the multiple of that pool the branch can lend in local currency, the more protectionist the requirement. Local Chinese banks will have less to fear in the way of "big" foreign banks leveraging off of their world-wide capital bases, because the People's Bank requirement is insulating the local banks from the competitive effects of the differential capital bases. Indeed, the operating capital of many Chinese banks was reported to be greater than many foreign bank branches in the PRC.

Even if the squabble over lending limits could be resolved, foreign banks were still hemmed in by the PRC's interest rate policies. Interest rates in the PRC had yet to be deregulated, and a robust inter-bank lending market had yet to develop. Absent these occurrences, it would be difficult for foreign banks to compete with local banks because regulated interest rates were a direct subsidy to Chinese banks. The government-mandated limits on what any bank (foreign or domestic) could pay depositors meant foreign banks could not compete with local ones by offering higher interest-earning accounts. Moreover, without a liquid inter-bank market, foreign banks were limited in their borrowing and lending operations. Their funding sources

(through inter-bank borrowing), and income-generating opportunities (through inter-bank lending), would be limited. International trade law was of no help either. Neither the November 15 bilateral agreement, nor the GATT-WTO rules, discussed interest rate deregulation or inter-bank markets.

Finally, conclusion of the bilateral agreement was marred by the reminder that unresolved problems in United States-Sino relations remained. The biggest example was, of course, Taiwan. Would the PRC now support Taiwanese accession? Would it emphasize peaceful reunification? How would it approach American regional security initiatives? A PRC "in from the cold" would likely to be hostile or fractious. However, better integration into the world trading system still had to transform strategic rivalry into strategic competition, or better yet, into strategic partnership.

B. IGNITING ECONOMIC AND POLITICAL CHANGE IN CHINA

History may have been repeating itself with the November 15, 1999 bilateral agreement. The Dragon was being carved up, possibly by foreign—principally, American—economic interests for the second time in two centuries. Maybe Premier Zhu had "sold" China to these interests. Perhaps he had to, because hard-liners in the Chinese Communist Party had shown little inclination to press reforms. The WTO accession process needed an external stimulus. Maybe Premier Zhu was not so much selling as betting—betting that participation in a market-oriented, open-trading system would lead to a brighter future than the past half-century of Maoism and socialist direction. Perhaps that Zhu was following Benjamin Franklin's remark that "no nation was ever ruined by trade."

SOEs posed a particular problem. There was great concern about weaning SOEs off of government milk. Would unemployment and the gap between rich and poor increase so dramatically that social instability would result? Certain sectors were particularly worrisome. As the world's biggest steel producer, the PRC boasted thousands of steel companies; however, only four were thought to be internationally competitive. In cement, the PRC had 8,000 plants, but most of them operated below the optimal production scale of one million tons annually. In agriculture, each Chinese worker farmed on average 0.1 hectares, whereas the average American farmer had 1.4 hectares, and

the average European farmer tilled 0.5 hectares. Small wonder that Chinese agricultural produce prices were as much as thirty percent higher than world-market levels. With the decline in tariffs, would the PRC be flooded with cheaper, higher quality steel, cement, and agricultural produce? Furthermore, the PRC's four major state-owned banks habitually lend to SOEs, which are the most troubled economic actors, but are restricted in lending to private companies, which are far more vibrant. Not surprisingly, therefore, in January 2000, the *Financial Times* reported that the state-owned banks were estimated to have bad loans equal to twenty-five percent of their assets. Were the central government to repair the balance sheets of state-owned banks through re-capitalization, government debt as a percentage of GDP would increase to almost fifty percent. Thus, many feared that once foreign banks began competing with state-owned banks, there would be a run on the latter.

Moreover, the nation's system of government was at issue. Maybe the deal was the beginning of the end of Party control. As *The Economist* said, the "central question" is:

[W]hether Chinese Communism will be strengthened by membership of the WTO - as China's leaders must hope - or be ruined by it. . . . The liberalisations that China has offered are sweeping, . . . and the main ones begin on the date of accession. . . . China's poor farmers, most of whom eke a living from tiny plots, now face competition from America's efficient agri-business. Industrial state companies will no longer be able to hide behind high tariffs and other barriers. State trading companies will no longer have a lock on imports. The telecom industry will be thrown open to foreigners. Foreign banks, at present constrained in what they can do and where they can go, will be freed. In other words, the state sector, the bastion of the Communist Party's power, will everywhere be undermined.

Why on earth should China's leaders have signed up to such an undermining? One answer is that many of them have not. This is a victory for the "reformers": Mr. Jiang, who seems to think that the kudos gained abroad by taking China into the WTO will soon rub off on him at home, and Mr. Zhu, who believes more strongly in membership on its own merits. Neither, however, is exactly a free-market liberal. They seem rather to have been swayed by two main arguments. One is that WTO membership will go a long way to securing for China the place at the high table of nations that most Chinese believe is theirs by right. The other, more immediately practical, argument is that China will benefit in terms of new jobs and fresh flows of foreign investment in a reinvigorated economy.

At bottom, of course, the Communist Party has made a calculation about how best to stay in power. Delivering prosperity, Party members acknowledge, is now the touchstone of its legitimacy. . . .

It is a gamble that may not pay off. The Chinese Communist Party is used to being above the law. With the PRC in the WTO, it will have to cede sovereignty -- upwards, to a rules-based, supranational body, and downwards to individual consumers and private companies at the expense of the state-industrial complex, the party's main base. To the extent that WTO membership requires a strengthened rule of law, so an emboldened judiciary might one-day be able to challenge Party decisions more effectively.⁵

Also, the Chinese people may be the wellspring of revolution in one form or another. WTO accession may mean the Party will need to ask ordinary citizens to make significant sacrifices in the transition to a market-oriented, globalized economy. Yet, it will have to make this request just as it loosens its grip on the people's economic behavior, because decentralization of economic power will be at the heart of the transition. For example, the government will have to privatize major state-owned banks, namely, the Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China, and the Agricultural Bank of China. Privatization will limit or eliminate the government's impact on lending policies. Instead of being compelled to lend to SOEs or favored enterprises, newly privatized banks will apply commercial criteria to prospective borrowers. In turn, government support for state-owned industry will erode.

Without the ability to direct credit, how will the Party keep the state sector afloat? Surely, it will seek more taxes from decentralized economic agents to help pay for cleaning up bankrupt SOEs and covering social welfare costs. But, here the government will crash into the paradoxical effect of WTO accession. On the one hand, the Party will need the people more than ever. On the other hand, the people will have more bargaining power than ever before, and may even reject some Party requests. Peaceful compromise may well entail greater participation in the Party (particularly if citizens are taxed excessively without representation), and in senior levels of government. That would be a democratic revolution - or perhaps better put, a democratic evolution.

5. *China Opens Up*, *ECONOMIST*, Nov. 20, 1999, at 17.

Perhaps, then, Premier Zhu was “China’s Gorbachev.” Ask any Russian about the Gorbachev legacy. It is hardly non-controversial. Indeed, the possibility of igniting not just significant economic, but also political change through WTO accession is a real one for Russia—and, for that matter, Saudi Arabia, Vietnam, and the other countries hoping to join the WTO club. For countries like Syria, Iran, and Laos that are considering WTO accession, economic and political change is a reality as well. Perhaps the accession process and its aftermath will compel more fundamental capitalist and democratic transformations, with all of the attendant problems as well as opportunities, in more countries than could ever have been imagined by a sage like Ben Franklin.

It is important to realize that these transformations are not simply legal ones. They are fundamental shifts in attitudes and culture at all levels of government. Consider the fact that in March 1999, China changed its Constitution to give private enterprises nearly equal footing with the state sector. Private enterprises still face a harsh climate because of discriminatory regulations implemented by protectionist government ministries. Unreconstructed officials continue to mistrust private firms. These firms are outside the traditional Communist Party system and, therefore, hard to control. Accordingly, the idea firms could own important infrastructure like water and power plants made officials uncomfortable.

Another example was the information technology sector. In January 2000, the government announced new rules aimed at preventing the “leakage of state secrets” over the internet into foreign hands. Internet companies became responsible for policing their own content in bulletin boards, chat rooms, news groups, etc., and the government had the right to close down offenders. The problem was the definition of “state secret.” It was so broad that it could encompass any information not specifically approved for release. Prominent American companies like Compaq, Dow Jones, Intel, International Data Group, and Walden, plus major Japanese companies that had invested in China’s fledgling internet sector now were faced with uncertainty and risk, thus raising the costs of financing their ventures. Thus, as the *Financial Times* asked: How could the PRC - so proud of this sector, and its strong pool of human capital - expect to foster information technology if it could not relinquish significant control over what people read and think?

The PRC's new rules on encryption technology furnish another example from the information technology of the reluctance of the Communist Party to relinquish control. In October 1999, they promulgated the Commercial Encryption Management Regulations, which took effect in January 2000. All foreign companies that used encryption technology had to register that technology with the newly created "State Encryption Management Commission." Foreign companies could not import or distribute any unregistered encryption technology in the PRC. The purpose of the regulations was to protect the PRC's information security systems, as the government saw encryption as a national security issue. It wanted to monitor all electronic communications, whether by e-mail, cell phone, or other form of mass communication. In effect, it seemed that foreign companies would have to hand over encryption technology to the government, which would hold it in escrow and perhaps use it whenever it felt the need to do so. As for all new encryption programs, it appeared they would have to be written either by a Chinese company approved by the government, or by a JV.

Even in the absence of ministry regulations, barriers remained that highlighted the tussle between developing a freewheeling, vibrant capitalist economy and maintaining discipline and social order. For instance, there were no regulations forbidding private firms from listing on the Shanghai or Shenzhen stock markets. Yet, only a handful of private firms had floated securities on these exchanges because the approval process for listing depended on recommendations from local governments. That meant that what ought to be an entirely market-oriented financial decision - whether and when to sell stock - was a political one. The financial services sector provided another example of the sea change needed. There was no law barring private investment in financial services. Yet, as of January 2000, all securities firms were in the hands of the state. There was only one privately owned bank - Minsheng Bank - and it required special approval to form.

The bottom line is that the optimistic vision of a prosperous, stable, responsible China is by no means assured of fruition. No one knows what will happen in China's post-WTO accession future - as President Clinton himself admitted in his January 27, 2000 State of the Union Address. The optimistic scenario for the PRC - and the likes of Russia, Iran, Saudi Arabia, and Syria - assumes that govern-

ments and the majority of their citizens will tolerate short- and medium-term chaos over dictatorship because they envision long-term stability through the prosperity of an open society. But as Karl Popper teaches, the open society has had enemies no less distinguished than Plato. Disappointments in economic restructuring, stagnation or even contraction, and an unseemly rise in corruption, by which the elite are enriched, assuredly will wreck the assumption. More than a few governments will be tempted to react to the consequent social tensions with old-style authoritarian political and economic measures, and GATT-WTO obligations be damned.

C. CAPITOL HILL POLITICS, REMAINING BILATERAL AGREEMENTS AND ACCESSION AT LAST?

The November 15, 1999 bilateral agreement with the United States was hardly the last step in the accession process, nor was it secured early enough to ensure accession during the Seattle Ministerial Conference. A protocol of accession would have to be agreed upon, followed by a vote in the WTO General Council. But, that would be the easy part. The WTO Working Party resumed its efforts to draft a protocol in March 2000. The hard part was the battle looming on Capitol Hill.

The Clinton Administration - backed by numerous business trade groups, vowed to fight vigorously to pass permanent, unconditional normal trade relations legislation (*i.e.*, an exemption from the Jackson-Vanik Amendment) for the PRC. So too did the Republican Congressional leadership, which saw PRC accession as integrally related to the search for new markets for American farmers and businesses. Moreover, compliance with international legal obligations was at stake. It would not do, under international law, to retain the apparatus of renewing MFN treatment annually on the basis of a Jackson-Vanik waiver, and condition such approval upon human rights criteria. That be tantamount to conditional MFN status for the PRC. Nor would it do to grant the PRC normal trade relations on an annual basis and call the grant "unconditional.," GATT Article I:1 demands unconditional treatment, and GATT jurisprudence (e.g., on Article III questions) has seen through the *de jure* - *de facto* distinction.

It was no secret why, in December 1999, the President personally vowed an "all-out effort" to pass the legislation. Already united against Clinton's Administration and Congressional allies stood the familiar but odd coalition of labor unions, human rights activists, conservative religious groups, consumer advocates, and some environmental organizations. This coalition was emboldened by its "victory" at the Seattle Ministerial Conference in blocking the commencement of a new Millennium Round of trade negotiations. Public Citizen's Global Trade Watch, for example, opposed permanent MFN treatment, advocating annual renewal of normal trade relations so as not to lose leverage over the PRC. Joining the coalition were politicians convinced of the PRC's evil intention to undermine America's national security by almost any means necessary. Many opponents advocated non-application of GATT-WTO obligations pursuant to GATT Article XXXV and WTO Agreement Article XIII. Of course, these advocates nonchalantly dismissed the fact that non-application would mean the PRC's market access concessions would not benefit American businesses, but would inure to their European and Asian competitors.

The coalition's case strengthened in February 2000. First, Vice President Albert Gore, campaigning (successfully) for the Democratic Party's presidential nomination, told union leaders he favored tougher labor and environmental standards and enforcement mechanisms within the fabric of trade accords. To be sure, Gore said he supported the PRC deal and WTO accession, but he did not encourage "big labor" - a key ally in his presidential quest - to reconsider its opposition.

Second, the State Department, in its annual human rights report, noted a marked deterioration in human rights, particularly freedom of religion, expression, and association. The United Nations High Commissioner for Human Rights, Mary Robinson, offered a similar denunciation shortly thereafter.

Third, the State Council issued a "White Paper" stating that the PRC would resort to "all drastic measures possible, including the use of force" to re-unify Taiwan if Taiwan refused "indefinitely" to negotiate the issue. It was not a "talk or fight" ultimatum, but it sounded ominous enough. Not surprisingly, the White Paper was hailed by the military's mouthpiece, the *People's Liberation Army*

Daily.

Were hard-liners in Beijing deliberately trying to sink the PRC's chances of accession, and thereby the painful reforms Premier Zhu was advocating? Was it a reckless attempt to stave off the inevitable decentralization of power that would occur with accession? Or was it just a crude attempt to discourage Taiwanese voters from backing pro-independence candidates in a forthcoming election? Within a week, Beijing denied that there had been any change in Taiwan policy. However, no one knew for sure, and the fact was, that on previous occasions the PRC had threatened attack only if Taiwan declared independence or was occupied by a foreign power. The damage had been done. The PRC's friends in the United States were put on the defensive yet again over human rights and Taiwan.

CONCLUSION

Thus, throughout the spring of 2000, storm clouds gathered over Capitol Hill on the issue of Permanent Normal Trade Relations, or "PNTR," for the PRC. By early May, the pro-PNTR forces appeared poised for a legislative victory. They had apparently persuaded enough members of Congress that PNTR would be a strong signal to reformers in Beijing, and it was in America's long-term interest to engage the PRC constructively by supporting these reformers. Perhaps, also, many in Congress had come to see that President Clinton's characterization of the 15 November bilateral agreement was correct: it was the "most one-sided trade deal in history." Thus, on 25 May, the House of Representatives voted narrowly, but decisively, to grant PNTR to the PRC. The vote was 237-197. As of this writing, the Senate is expected to follow suit in the early fall of 2000.

There were sure to be at least two grand ironies for the Clinton legacy. First, when the President initially had taken office, he had expressly linked renewal of the Jackson-Vanik Amendment waiver to the PRC's human rights performance. That same President would go down as the prime catalyst behind the greatest trade deal between the Eagle and the Dragon. He had rejected protectionist forces in his own party, and followed every American head of state since Richard Nixon as an enthusiast for constructive engagement to export democracy and human rights. After all, three out of four Republicans voted for the PNTR measure, while two out of three Democrats opposed it.

Indeed, it was the third time President Clinton rebuffed his fellow Democrats—the 1993 NAFTA Implementation Act, and the 1994 Uruguay Round Agreements Act being the first two occasions.

Second, the very House Republicans who in 1998 had impeached the President because of Monica handed him his greatest foreign policy triumph. The President needed them all the more in 2000 than in 1993. Thirty nine percent of House Democrats (102 out of 258) voted for NAFTA, while thirty-five percent (seventy-three out of 211) voted for PNTR.

However, the Capitol Hill storm over PNTR was not Beijing's only worry. The PRC also had yet to finish bilateral agreements with the EU and about a dozen other trading partners, including prominent ones such as Mexico, and Switzerland, and less prominent ones like Costa Rica, Ecuador, Guatemala, the Kyrgyz Republic, Latvia, and Poland. (It was able to wrap up deals with Brazil, Cuba, Iceland, Norway, Peru, Sri Lanka, and Uruguay in January 2000, with India and the Philippines in February, with Argentina, Colombia, and Thailand in March, and with Malaysia in April.) While some of these Members had trading interests in the PRC that overlapped with the United States, some did not, and no Member had interests identical to those of the United States. India was a case in point. It demanded improved market access for its software developers to work in the PRC. Other Members could hold out for better deals, which would then be "multi-lateralized" because of the MFN obligation.

For example, the EU said it found about eighty percent of the bilateral agreement with the United States acceptable for itself. But, the EU wanted deeper tariff cuts on automobiles, and on about 300-400 products that it exported to the PRC in larger volumes than did the United States. These products included agricultural equipment, ceramics, cognac, cosmetics, glassware, leather goods, machinery, mandarin oranges, shoes, and spirits. The EU also sought at least the same number of operating licenses for life insurers as the United States obtained, and wanted the PRC to permit foreign life insurance companies to take a controlling stake in JVs. Similarly, it sought more than fifty percent foreign ownership of telecommunications operators in fixed-line services, mobile-telephony, paging, and satellite phones. The EU remained concerned about Chinese export performance requirements, whereby some foreign manufacturers were re-

quired to export as much of seventy percent of their product made in the PRC, and about conditions on product distribution and technology transfer.

The Chinese refused to budge on equity percentage limitations in the insurance and telecommunications sectors. They rightly asked the EU rhetorically why the Europeans should get a concession denied to the Americans. The EU Trade Commissioner, Pascal Lamy, acquiesced, recognizing that the phased-in forty-nine percent and fifty percent limits on mobile telecoms and insurance were a “political no-go zone.” The EU could not, and would not, push those matters any further.

Fortunately, once again with Premier Zhu Rongji’s personal involvement, the Chinese did offer the EU a few concessions that proved decisive.

- *Tariff reductions.* The PRC agreed to cut tariffs by forty percent, to an average of 10.9 percent, on 150 products of particular interest to the EU. Such products included ceramics, cosmetics, leather, machinery, and spirits. Some of the tariff cuts would be dramatic: on cosmetics, from an average of thirty percent to ten percent; on spirits, from sixty-five percent to ten percent.

- *Agriculture.* The PRC said it would reduce even further tariffs and tariff-rate quotas on agricultural commodities of particular interest to the EU, such as butter, mandarins, milk powder, olives, pasta, rape oil, and wine.

- *Automobiles.* While the PRC brushed off the EU’s demand for further cuts in import tariffs, it did agree to relax restrictions on JVs in car, van, and truck production.

- *Distribution.* The PRC promised to lift equity restrictions on large department store joint ventures, allowing them to run wholly-owned networks. It also promised to eliminate rules prescribing the maximum size (i.e., floor space) of foreign-owned stores. Accordingly, it would be easier for the likes of European retailers such as Ahold, Carrefour, and Ikea to do business in the PRC.

- *SOEs.* The PRC agreed to end its state trading monopoly on imports of crude and processed oil, and on fertilizer. Private traders would be allowed to import these items, hence state companies like Sinopec and Sinochem would lose their power to fix prices (which

they often exercised, setting the prices at below world-market levels). As soon as the PRC acceded to the WTO, foreign oil and oil produce exporters (e.g., European giants like BP and Royal Dutch/Shell) would be permitted to sell twenty percent of their exports to the PRC to non-SOEs at market prices. This percentage would rise to 100 percent, in fifteen percent increments each year following accession. Fertilizer exporters (e.g., Germany's BASF) would be able to export a quota equal to 2.7 million tons annually, with an in-quota tariff rate of four percent. They could carry over to the subsequent year any unused portion of the in-quota amount. Finally, the PRC's export monopoly on silk would be liberalized.

• *Legal services.* The PRC promised foreign law firms could offer advice on Chinese law, and restrictions on their recruitment of attorneys would be eased.

Moreover, even in the insurance and telecommunications sectors, the PRC came up with a creative solution. The PRC promised an additional seven licenses within three months to European insurers (in both the life and non-life insurance sectors), and to advance by two years the dates by which foreign companies could form JVs in life insurance and mobile telephony. Thus, for example, a mobile telecom company would be able to take a twenty-five percent stake in a JV upon the PRC's accession, a thirty-five percent stake after one year, and a forty-nine percent stake after three years.

Arguably, some of these offers were of dubious value. The PRC was likely to liberalize its state monopolies on oil imports and silk exports, regardless of the WTO accession process. As for distribution, not too many Chinese yet had the purchasing power to do anything but window shop at the likes of Galleries Lafayette or Printemps.

Still, on balance, the offer was good enough for the EU. On 19 May, the two sides signed a bilateral concession agreement that contained the aforementioned points, all of which would apply to every WTO Member when the PRC joined the WTO. With the EU deal, and passage of PNTR in the House of Representatives, the saga of China's accession to the WTO was nearing an end.

At long last, the Dragon appears about to enter.

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