

# The Possible Impact of China's WTO Membership on the WTO Agricultural Negotiations<sup>1</sup>

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## **Abstract**

Given China's impending membership of the WTO, this paper makes a first attempt to predict China's negotiating strategy in the current agricultural trade negotiations in the light of its food policy objectives, trade position and its accession offer on agriculture. China's interests with respect to market access are seen as closer to the EU position in the negotiations, while its interests regarding export subsidies, domestic supports and SPS issues are closer to the US position. Its specific negotiating objectives are unlikely to seriously threaten either US or EU interests, and China will be in a strong position to influence the final outcome by allying itself with whichever partner is most willing to accommodate its objectives.

## **Keywords**

China; World Trade Organization; agricultural trade policy

## **JEL classification**

F13, Q17

## 1 Introduction

China's 'long march to Geneva'<sup>2</sup> was successfully concluded at the WTO's Working Party on China's Accession in July 2001<sup>3</sup>, fifteen years after China formally applied to rejoin the GATT in 1986.<sup>4</sup> It is hoped that the terms of China's accession will be formally approved by WTO trade ministers in November 2001 in Doha, Qatar. China must then ratify the terms of its accession, probably in the early part of 2002, after which it will become a full WTO member.

China's accession to the WTO will have far-reaching significance both for China itself and for the rest of the world. One writer, with understandable enthusiasm, has argued that "...the final accession of China into the WTO will be remembered as one of the most important events of this century" (Wen, 2000). The framework of rules and obligations which China will take on as a WTO member will dramatically accelerate the changes in domestic policies and laws which were initiated with the open-door policy in 1979. No less important will be the impact of China's participation in shaping the rules of world trade, not least in the Millennium Round of trade negotiations which it is hoped WTO trade ministers will also launch in Qatar.

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<sup>2</sup> The expression comes from the title of Leonard's (1999) book on the process which led to China's admission to the WTO.

<sup>3</sup> Almost all of the negotiations were completed at this Seventeenth Meeting of the Working Party. The Working Party plans to meet for the last time in September to approve the accession documents. See Frances Williams, 'China close to finalising WTO entry negotiations', *Financial Times* 20 July 2001.

<sup>4</sup> China was one of the 23 founding members of the GATT in 1948, but withdrew in 1950 after the formation of the People's Republic.

Whether or not a comprehensive round of trade negotiations is launched in November, China will be entitled to participate in the ongoing negotiations on the WTO's so-called 'built-in agenda', the various mandates to continue negotiations in specific areas which were included in the Uruguay Round (UR) Agreements. These include a new round of WTO negotiations on agricultural trade which began in March 2000 as a direct outcome of the Uruguay Round Agreement on Agriculture. These negotiations have had an active start. By the March 2001 stock-taking meeting, 125 countries (counting the EU<sup>5</sup> as 15) out of a total of 141 WTO Members had submitted a total of 44 sets of proposals and 3 technical submissions. The negotiators have agreed a further series of meetings to examine these proposals in greater detail, and a further review of progress will be held in March 2002 before entering into the bargaining which will be necessary to reach a consensus agreement. No target date has, as yet, been set for the conclusion of these negotiations and this will, in turn, depend on whether the agricultural negotiations become part of a more comprehensive round. In either case, China is likely to be a participant in the final stages of these negotiations and to influence the shape of the final outcome.

China is a major player in world food markets. Most of the literature on the agricultural aspects of China's WTO accession to date has focused on its implications for world prices and trade volumes (Colby et al, 2000; Fuller et al, 2001; Schmidhuber, 2001). But China's accession will also have great importance for the agricultural negotiations because of its influence on the negotiating dynamic and the alliances formed between the principal participants in the negotiations: the EU, the US, the Cairns Group, Japan and the developing countries.<sup>6</sup> The key question is whether China will tend to side with the

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<sup>5</sup> In the WTO, it is formally the European Communities (EC) which negotiates on behalf of the 15 member states. We refer to the EU throughout this paper as it is now the commonly accepted usage.

<sup>6</sup> See Gilmour and Brink, 2001 for another view of this issue.

‘liberalisers’ - those countries seeking a rapid reduction in remaining agricultural protection and support – or with the ‘friends of multifunctionality’ who seek to retain the possibility of coupled production support for specific food, environmental or rural development objectives. The negotiations are, of course, more nuanced than this simple dichotomy suggests and not all countries can be pigeon-holed into these two groups. China will have particular negotiating objectives to pursue and will seek to build alliances that maximise its probability of success in achieving these objectives. This paper makes a first attempt to predict China’s negotiating strategy in the light of its food policy objectives, trade position and its accession offer on agriculture.

The key hypothesis put forward is that China’s interests are more orthogonal to, rather than either complementary to or conflicting with, those of the two main participants in the agricultural negotiations, the US and the EU. China’s history of extensive government intervention in agricultural markets would seem to make it a natural ally of the EU in resisting full-scale agricultural liberalisation. However, China will have little immediate interest in making direct payments to farmers whether under ‘blue box’ constraints or to pursue multifunctional objectives, and will have already agreed to refrain from the use of export subsidies, both of which are key EU interests. On the other hand, China is unlikely to share the US interest in immediate and widespread liberalisation, despite its low average agricultural tariffs after WTO accession; its grain security apprehensions are too sensitive for that. China’s objectives will be quite specific to its own concerns: lower tariffs on its fruit, vegetable, aquatic and processed food exports; safeguards against unduly low world prices; the maintenance of its tariff rate quotas and state trading of grains; and recognition of its status as a developing country in the application of domestic supports. None of these demands would directly threaten either US or EU interests, although it is possible that the EU would find it easier to accommodate them. China thus will be in a strong position to influence the

final outcome of the negotiations by offering its support to whichever country most facilitates its pursuit of its specific objectives.

Section 2 of the paper sets the context by examining China's recent food policy objectives and agricultural trade situation and policy. Section 3 describes what is known about China's WTO offer in agriculture at this point in time and summarises the results of recent studies of the impact of China's WTO accession on its agricultural production and trade. Section 4 speculates on China's likely attitude to some of the key negotiating issues in the current agricultural round. In this section, the US and EU negotiating proposals are used to define the negotiating 'space' within which China can manoeuvre. Section 5 concludes the paper.

## **2 China's food policy and trade**

The extraordinary growth in China's GDP in the post-reform period after 1979 has been accompanied by rapid change in the structure of its economy (Table 1). Agriculture contributed 40% of Chinese GDP in 1970, but its share fell to only 18% in 1999. However, agriculture's employment share, which amounted to 81% in 1970, remains very high at 50% in 1999. China is still overwhelmingly rural, with 69% of its population living in rural areas even in 1999.

Grain self-sufficiency has been central to Chinese agricultural policy and agricultural policy reform has closely reflected developments on its grain market. Over the reform period, China has moved from a position where it significantly taxed agricultural producers to one where producer prices are close to world market levels or, in the case of grain, even above world market levels in recent years. The downturn in grain production and the jump in grain prices in the mid-1990s was a severe shock to the Chinese authorities and reinforced their

commitment to maintain a high degree of self-sufficiency in grain. Since the mid-1990s, a series of measures has been introduced, including price support, in pursuit of this objective. Indeed, recent policies even emphasise grain self-sufficiency at the provincial level through the provincial governors' grain responsibility system.<sup>7</sup> As a result, China has experienced bumper harvests (apart from a drought in 2000) and grain imports in recent years have almost vanished.

**Table 1. Changes in the structure of China's economy, 1970-99, per cent**

	1970	1980	1985	1990	1995	1999
Share in GDP						
Agriculture	40	30	28	27	20	18
Industry	46	49	43	42	49	49
Services	13	21	29	31	31	33
Share in employment						
Agriculture	81	69	62	60	52	50
Industry	10	18	21	21	23	23
Services	9	13	17	19	25	27
Share in agricultural output						
Crop	82	76	69	65	58	58
Forestry	2	4	5	4	3	4
Livestock	14	18	22	26	30	29
Fishery	2	2	3	5	8	10
Share of rural population	83	81	76	72	71	69

Source: Huang, 2000 based on State Statistical Bureau, China Statistical Yearbook, various issues; and China Rural Statistical Yearbook, various issues.

China is now a significant food exporter, with exports of \$11.0 billion in 1999 compared to imports of \$6.9 billion. China accounts for one-sixth of the world's food market

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<sup>7</sup> This policy introduced in late 1994 gives provincial governors the responsibility to maintain the 'grain bag'.

Governors are to stabilise the area sown to grain crops, guarantee investment in agricultural inputs to

despite its still relatively low per capita income. More detail on the structure of exports and imports is shown in Table 2. In eight out of the eleven product categories China was a net exporter in 1999. Particularly impressive is the growth in exports of the fruit and vegetables and fish categories, both of which now account for \$3 billion of exports annually. On the import side, China's principal imports are oilseeds and vegetable oils. The 'governors' grain responsibility system' does not cover oilseeds or their products which enjoy a relatively liberal policy regime (OECD, 2000a). Over the last few years, this has combined with freer trade to promote rapidly rising imports of oilseeds, oilmeals, and vegetable oils, especially soybeans, soya products, rapeseed and palm oil. Meat and dairy product imports are conspicuously low.

**Table 2. Structure of China's agricultural trade, 1980-1999, US\$ million**

Commodity	SITC	1980		1985		1990		1995		1999	
		Export	Import	Export	Import	Export	Import	Export	Import	Export	Import
Live animals	00	384	5	304	18	430	14	473	18	374	22
Meat etc.	01	361	1	448	6	791	54	1,349	97	1,054	503
Dairy products etc.	02	71	5	57	31	55	81	61	60	71	160
Fish etc.	03	380	13	283	44	1370	102	2,875	609	2,969	890
Cereals etc.	04	423	2458	1065	982	614	2353	281	3,631	1,273	574
Vegetables and fruits	05	746	48	825	52	1759	83	3,399	185	3,150	384
Sugar etc.	06	221	316	79	274	317	390	321	935	214	183
Coffee, tea etc.	07	328	56	435	40	534	30	523	74	561	72
Animal foodstuffs etc.	08	58	14	241	83	623	182	351	423	239	620
Others	09	49	2	66	23	107	46	290	92	541	182
Hides and skins	21	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	51	411	13	408
Oilseeds	22	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	522	110	373	1,531
Vegetable oils	4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	454	2,596	132	1,352
Total food		3,021	2,918	3,803	1,553	6,600	3,335	10,951	9,239	10,964	6,882

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stimulate grain production, and stabilise grain prices. Additional production is stimulated by subsidised inputs (notably fertiliser, pesticides and water) and by administrative pressures.



Source: Feng (1999) for the 1980, 1985 and 1990 data; OECD International Trade Statistics database for the 1995 and 1999 data. Feng also provides the 1995 data which are similar to those reported here. He does not give data for trade outside the SITC 0 category.

China's net food exporter status reflects, in part, the restricted market access it allows to imported agricultural products. High tariffs, quantitative barriers, sanitary and phytosanitary measures and regulation of market access are the major obstacles. China's average tariff rate for agriculture is around 22 per cent<sup>8</sup>, but many products are protected by much higher rates. Figure 1 shows the applied MFN rates for bulk agricultural commodities levied in 1998. Imports of grains and oilseeds, however, can enter under a tariff rate quota system at a reduced rate of duty. China introduced tariff rate quotas (TRQs) for wheat, maize and rice in 1996, although no rules covering their administration or actual quota volumes have been revealed publicly (Schmidhuber, 2001). In-quota tariff rates in 1998 varied from 8.7 per cent on average for wheat, 3.1 per cent for rice and 10.8 per cent for maize. In 1996, China also announced it was introducing TRQs for oilseeds but it failed to implement these and relied instead on readily available import licences to regulate trade flows. Soybean imports are subject to a 3 per cent in-quota tariff while soybean meal imports incur a 5 per cent in-quota tariff. Soybean oil, in contrast, is subject to a quota system and a 13 per cent tariff.

China limits the types and numbers of enterprises that have the legal right to engage in international trade. Only firms granted trading rights may import products into China and have access to China's distribution system. In addition, some products such as grains, cotton and vegetable oils can be imported only or principally through state-trading enterprises (STEs). The most important of these is COFCO (China Cereals, Oils and Foodstuff Import

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<sup>8</sup> The 22 per cent figure is the US estimate contained in the White House Fact Sheet on the US-China WTO Accession Deal and US Agriculture, 10 February 2000.

and Export Company). The consequence of this closely-regulated trading system is that reducing tariffs is unlikely to be effective without liberalising trading rights and reducing the role of STEs in China.

Direct export subsidies and VAT rebates for exporters formed the main elements of China's past export promotion policies. Direct subsidies were abolished on 1 January 1991 and in 1997 China assured a WTO working party it would not resurrect them (OECD, 2000a). However, it has been reported that China subsidised its maize exports in 1999 and 2000 as a way of reducing excessive stocks (Schmidhuber, 2001). Cereal exports can also benefit from indirect export subsidies. COFCO can buy low-price 'quota grain' from the domestic procurement system and sell it on world markets at prices below the domestic price. The subsidy element is financed by grain producers who must deliver a percentage of their production quota at lower procurement prices. The VAT rebate system also functions as an indirect export subsidy. While the reimbursement of VAT paid on inputs is a normal commercial practice and does not in itself constitute a subsidy, China is alleged to use varying and discretionary VAT reliefs and exemptions as a way of managing both imports and exports (Schmidhuber, 2001).

### **3 China's WTO accession offer in agriculture**

The full details of China's agricultural offer are not yet known, as the Schedule of Commitments will be based on the best offers made in the bilateral negotiations which have taken place with the 37 WTO members which requested them. However, enough is known of the outcome of the bilateral negotiations with the US and the EU, in particular, to be able to construct the shape of the final accession offer. The agricultural market access concessions include tariff reductions, the establishment of tariff rate quotas for bulk commodities,

commitments not to use export subsidies and to reduce domestic support, and a phase-out of restrictions on trading rights.

Tariffs on agricultural products will be cut from an overall average of 22% to 14%. Tariff cuts for selected products drawn largely from the US bilateral agreement are shown in Table 3. Further tariff reductions agreed in the EU-China bilateral negotiations include rape oil (down from 85% to 9%), pasta (down from 25% to 15%), butter (down from 30% to 10%), mandarins (down from 40% to 12%), olives (down from 25% to 10%) and wheat gluten (down from 30% to 18%). Tariffs on all spirits are reduced from 65% to 10%.

In addition, China plans to use a TRQ system to expand market opportunities for a number of bulk commodities including wheat, maize, rice, soybean oil, cotton, wool, sugar, palm oil and rapeseed oil. All of these commodities, except for wool, are currently subject to state trading. The quantities of these commodities allowed in at the low 'within-quota' tariff rate (1-3%) will increase annually from 2000 through 2004 (except for soybean oil which will be fully liberalised with nothing but a bound duty by 2006). Overall, the total TRQ for grains will amount to 22.1 mmt. In addition, there will be some imports of barley outside the TRQ system which will be offset by continued exports of low-quality rice. Given that grain consumption in China in 2005 is projected to be around 420 million tonnes, these limits will allow China to maintain its 95 per cent grain self-sufficiency objective after accession, even assuming that the TRQs are binding.<sup>9</sup>

As noted above, only companies that receive specific authorisation from the Chinese government are currently allowed to import into China. Under the US Agreement, China has committed to allow any entity to import most products into any part of the country within three years of accession. At the end of this transition period, all foreign and domestic

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<sup>9</sup> Some projection studies find that the TRQs will not be binding at least until 2010 (Fuller et al, 2001).

enterprises will have trading rights. A select list of products will be partially exempt from this rule. Some trade will be channelled through China's state-trading enterprises (including wheat, corn, rice and cotton; however, state trading will be phased out for soybean oil). However, in the case of the TRQs for these products, a growing share of the rising TRQ imports is reserved for non-state trading entities to encourage private sector participation in China's trade activities. China has also committed to liberalise distribution services for all agricultural products, except tobacco, allowing foreign companies to distribute and market their products in China.

**Table 3. Selected tariff bindings offered by China**

Commodity	Current tariff levels	Likely out of quota final bindings
	%	%
Barley	91	9
Beef	45	12
Pork	20	12
Poultry	20	10
Soybeans	114	3
Wheat, maize, rice	114	65
Milk powder	25	10
Wine	65	14
Citrus	40	12
Cheese	50	12

Sources: Martin 1999, Hanrahan 2000, EU press release<sup>10</sup>, OECD 2000a.

China has further agreed not to use export subsidies after accession. It has also agreed to cap domestic subsidies and to make them more transparent and predictable. The specific level of the cap was one of the most contentious issues in the Working Party negotiations on accession. China insisted that it should be allowed developing country status and held out for the 10% *de minimis* exemption and more favourable treatment of certain domestic support

policies which would follow from its acceptance as a developing country. Developed countries, and the US in particular, were willing to grant China no more than the 5% ceiling allowed to developed countries. Recent reports suggest that a compromise 7-8% limit was acceptable to all sides (*Financial Times* 23 May 2001).

In return for these concessions, China will gain access to the markets of existing WTO members on MFN terms. The likely impact of WTO accession on the future outlook for China's food economy is hotly debated, not least because rapid economic growth is radically changing the economic environment for China's food production and demand and makes projections particularly uncertain. The conventional wisdom is that grain markets will experience a sustained demand increase driven by growth of population (expected to reach 1.6 billion in 2020), rapid urbanisation, rising income levels and the expansion of the livestock sector (as a consequence of growing meat consumption). These factors are unlikely to be matched by compensating shifts in the supply of grains due to (i) the transition of land, labour and capital to non-agricultural uses, (ii) a slowdown in yield growth, and (iii) environmental degradation (erosion, salinisation). However, the recent forecasts published by three of the main agencies which undertake medium-range agricultural projections – the US Department of Agriculture (USDA, 2001), the OECD (OECD, 2000a) and the Food and Agricultural Policy Institute (FAPRI, 2001) - indicate relatively limited import growth in the next decade. For example, the USDA in 2001 projected grain imports in 2010/11 of 10.7 million tonnes, while the FAPRI figure is 13.7 million tonnes.

These projections are based on the technical assumption of unchanged policies and do not incorporate the likely impact of China's accession to the WTO. A review of recent studies which have addressed this question using both partial and general equilibrium methodologies

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<sup>10</sup> Highlights of the EU-China agreement can be found at

<http://europa.eu.int/comm/trade/bilateral/china/high.htm>.

leads to the conclusion that, while WTO accession will lead to some increase in China's net agricultural imports, it is unlikely to have a dramatic effect on its grain self-sufficiency ratio.<sup>11</sup> There seems no reason to expect a dramatic deterioration in China's grain self-sufficiency ratio either as a result of economic structural change, or as a result of WTO accession, in the medium term. China has a number of alternative ways to promote grain self-sufficiency apart from price support, including investment in research and infrastructure, liberalisation of its internal grain market and greater security of land tenure for farmers. All of these policies will continue to be available to the Chinese authorities after WTO membership. Another implication of the modest projected increase in China's net food imports after accession is that the effect on world market prices will not be dramatic. Fuller et al. (2001), for example, forecast that maize, wheat and soybean prices will rise by less than 3.5 per cent, and the biggest effect will be felt in world cotton markets where international prices increase 11.2 per cent by 2010. To the extent that more buoyant world markets make it easier for countries to agree to reduce agricultural protectionism, there is little evidence that China's accession will contribute to increased liberalisation through this channel.

#### **4 China's interests in the current round of WTO agricultural negotiations**

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<sup>11</sup> Recent studies applying a partial equilibrium methodology include Iowa State University's FAPRI model (Fuller et al, 2001), the OECD's AgLink model (Schmidhuber, 2001), the CAPSIM model maintained by the Centre for Chinese Agricultural Policy at the Chinese Academy of Agricultural Sciences (Huang, Rozelle and Rosegrant, 1999; Huang, Chen, Rozelle and Tuan, 1999; Huang, 2000) and the Country Linked System of models developed at USDA's Economic Research Service (Colby et al. 2000). General equilibrium studies include Wang 1997, Anderson et al. 1997, Huang and Yang 2000, Li and Zhai 2000 and Felloni et al. 2000. In comparing study results, a key difference is what each study assumes about China's WTO offer and how this is modelled. See also the articles by Huang, Rozelle and Zhang (2000) and Lin (2000).

This section assesses the position which China might take on the various issues which have been raised to date in the current round of agricultural trade negotiations. China is not yet a participant in these negotiations. The views attributed to it in this section are speculative but informed by the analysis of China's agricultural policy objectives and trade regime presented earlier. It is clearly of interest to the main participants to try to define where China's negotiating interests will lie in order to assess the possibility of building alliances around specific issues. In particular, we focus in this section on the impact of China's membership on the US/EU dialogue by identifying those areas where China's interests are likely to coincide with those of the EU and the US, and where those interests are likely to differ.<sup>12</sup>

#### **4.1 Market access negotiations**

The market access negotiations revolve around (a) the depth of future tariff reductions (b) the pattern of future tariff reductions, (c) safeguards against unusually low world market prices (d) the extent of any increase in the tariff rate quotas, and (e) the administration of tariff rate quotas.

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<sup>12</sup> The US tabled its initial position paper on agriculture on 23 June 2000 entitled 'Proposal for Long-term Agricultural Trade Reform (WTO:G/AG/NG/W/15). This contained proposals for reform in each of the key areas of market access, export competition and domestic support. It submitted further notes elaborating on its proposal for domestic support reform (G/AG/NG/W/16) and on reform of TRQs (G/AG/NG/W/58). The EU has submitted four papers on specific issues it wished to raise in the negotiations (Blue box support G/AG/NG/W/17; the protection of regional food names G/AG/NG/W/18; animal welfare G/AG/NG/W/19; and export competition G/AG/NG/W/34). It also joined with a number of other countries in submitting a proposal on non-trade concerns (G/AG/NG/W/36). It subsequently submitted its comprehensive proposal on 16 December 2000 (G/AG/NG/W/90).

#### **4.1.1 Amount and structure of tariff reductions**

The twin objectives of the US proposal on tariffs are to (i) substantially reduce or eliminate all tariffs by annual reductions over a fixed period, and (ii) substantially reduce or eliminate disparities in tariff levels both across countries and across products (tariff escalation). One consequence is that higher tariffs (those on more sensitive commodities) would be reduced by more than lower tariffs. It also proposes the elimination of the Special Safeguard Arrangement, agreed under the URAA, whereby importing countries may temporarily raise duties in response to sudden import surges for those commodities which underwent tariffication, provided this right was scheduled in a country's WTO commitments.

The EU takes the opposite approach in proposing that the formula for tariff reductions should be a commitment as to the overall reduction of bound tariffs and a minimum reduction per tariff line, as was the case in the Uruguay Round. Its arguments for the continuation of the Uruguay Round approach include that it allows for sufficient flexibility in lowering tariffs to allow members to take into account the particular situation of specific sectors. Decoding this, the effect would be to allow countries to reduce tariffs on sensitive sectors by less than the overall average agreed, thus having the opposite effect to the US proposal. To date, no figures have been proposed as to what this overall average might be.

Multilateral tariff reductions have two consequences. They increase market access abroad for a country's exporters, while opening up the domestic market to increased competition. It is thus not surprising to find net exporting countries pushing more enthusiastically for significant tariff reductions than net importing countries. The US, EU and China are all currently net agricultural exporters, although their comparative advantage differs across commodities. In China's case, it has export interests in vegetables, horticultural crops, fish products and possibly intensive animal products (pigmeat and poultrymeat). Martin (1999) used the GTAP 4 database to examine the duty burden on China's agricultural exports



and estimated that the average tariff rate faced by China on its agricultural product exports was, at 32 per cent, four times higher than the average tariff faced on its exports of other products. This suggests there are definite export market gains worth going after for China in the current round of negotiations.

The costs of opening the domestic market to greater import competition must be set against these export gains.<sup>13</sup> This cost, in turn, will be a function of the existing level of import protection. China's average tariff of around 14% post WTO entry will put it in the lowest quartile of countries with respect to agricultural protection rates (for data on mean agricultural protection rates by country, see Gibson et al, 2001). In general, China's tariff structure appears much lower than the EU (where the average is 30 per cent) but is on a par with that of the US (whose average is 12 per cent, both figures from Gibson *op. cit.*). The implications of low tariff bindings for China's future stance in tariff negotiations are ambiguous. On the one hand, the fact that tariffs are low and thus provide little protection could mean that the Chinese authorities will not object to further cuts in these tariffs.<sup>14</sup> The other possibility is that, precisely because protection is so limited at present, the Chinese authorities will be reluctant to see it further reduced. The experience of other liberal economies with low rates of agricultural protection (for example, members of the Cairns Group) suggests that, on balance, the Chinese may feel they have more to gain from further

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<sup>13</sup> The term 'cost' here is used to denote the political cost to a government from import-competing interests. Under standard economic assumptions, trade liberalisation gives rise to economic benefits, not costs. Political costs can arise because the way in which economic gains and losses are distributed can be perceived differently by different groups in the population.

<sup>14</sup> Another motive for tariffs, particularly in developing countries, is as a source of government revenue. However, China has a very small dependence on agricultural tariffs for government revenue and the loss of this tariff revenue would be easily made up through other sources.

reductions. However, while this may be their general stance, it will not necessarily apply across each commodity. Their attitude to lower tariff levels for individual commodities will depend on the trade balance and the existing level of protection for those commodities.

**Table 4. Comparison of tariff rates on agricultural products for US, EU and China**

	US	EU	China post-WTO entry (projected)
Grains	2	53	65
Oilseeds	17	0	3
Oilcake	2	3	5
Vegetable oils	4	13	9
Meat: fresh beef, pork or poultry	12	41	25
Meat: frozen beef, pork or poultry	9	66	12
Dairy	43	87	10-12
Fruit: fresh	4	21	12
Vegetables: fresh	7	16	n.a.
Sugar beet	0	349	n.a.
Sugar cane	1	56	n.a.
Sweeteners	46	59	n.a.

Source: Gibson et al., 2001 for US and EU average tariff rates; China data from Section 3 of this paper.

Note: US and EU tariffs are bound final tariffs after URAA implementation. They are unweighted averages of the *ad valorem* tariff equivalents levied on all tariff headings within that commodity grouping. Because many of the tariffs levied by the US and the EU are specific or mixed tariffs (in both countries 44 per cent of all tariffs are specified in non-*ad valorem* terms), calculating a tariff average requires making use of average import unit values in order to compute the *ad valorem* tariff equivalents. The Chinese tariffs are not directly comparable as they refer to representative commodities within the tariff group rather than being unweighted tariff averages. The effect of averaging would be to reduce the figures shown in the Chinese column. For example, in the grains category, the tariff on wheat gluten will be 18%, on pasta 15% while the tariff on barley will be 9%. Once these lower rates are averaged in, the mean tariff on grains will be much less than the 65% shown in the table which applies to bulk wheat, maize and rice only.

A comparison of the tariff structures of the US, EU and China is shown in Table 4. The three countries have quite dispersed tariff structures (meaning that the tariff rates levied

on individual commodities are quite variable), but the sensitive commodities in each country's tariff schedule are different. China will have a pattern typical of many developing countries where the highest tariff protection is maintained on grains for largely food security reasons. Support to animal production is much more limited. Indeed, if domestic grain prices exceed world market prices due to protection, this could result in negative effective protection to China's intensive animal producers, although this will be mitigated by the essentially tariff-free import of protein feed sources. In the case of the US and the EU, on the other hand, the highest protection is provided to animal producers (particularly dairy and beef farmers) and to sugar beet growers. If account is taken of the fact that grains and oilseeds trade at close to world market levels, then the effective protection provided to US and EU dairy and beef farmers is even higher than the nominal tariff rates suggest.

These considerations suggest that China's interests in further tariff reductions will lie midway between those of the EU and the US. As an exporter, China will be keen to push for a significant further cut in tariffs in the next round. However, it will be conscious of the implications of any cut on its out-of-quota tariffs on wheat, maize and rice. There appears to be considerable 'water' in these tariffs at the present time.<sup>15</sup> Although domestic grain prices in China between 1997-2000 appear to be somewhat above world prices, over the longer run market prices are close to world market prices. As world market prices recover following the

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<sup>15</sup> Producer prices in China are not as much above world market prices as the simple tariff figure might suggest, which might be an indication that some of the tariff protection is redundant and could be removed without an adverse effect on domestic prices – hence the phrase 'water in the tariff'. Another explanation for the low producer prices compared to the amount of tariff protection might be that grain handlers and processors in China are not as efficient as their overseas competitors and may take advantage of their monopoly position to depress prices to farmers. In this situation, lowering tariffs would have an adverse effect on domestic producer prices unless there was a simultaneous improvement in processing and handling efficiency.

Asian downturn, current levels of protection may well disappear. Thus China may be less concerned about the impact of substantial tariff cuts that might appear at first sight. On the other hand, as these lower tariffs would be bound, they would reduce China's freedom of manoeuvre to increase protection to its grain farmers in the future. But its ability to provide increased price support in future will in any case be circumscribed by its domestic support commitments (see below).

China's concerns would be further eased if the Uruguay Round formula were again applied, as this would allow it to limit the cuts in out-of-quota grain tariffs to less than the average agreed. China may well calculate that, in the Asian markets of most interest to it, the minimum reductions will apply largely to food grains (where it has little comparative advantage) rather than to the commodities where it can show export gains. Thus, China may not benefit greatly by insisting on a tariff-cutting approach which reduces very high tariffs disproportionately in order to achieve the harmonisation of tariffs as the US has proposed.

#### **4.1.2 *Tariff rules and price stability***

WTO membership will mean that China's grain economy will become increasingly integrated with the world grain economy. One of the concerns of China's policy makers is that volatility of world market prices will spill over into fluctuations in domestic grain prices in a more liberal market. Tariffication in the Uruguay Round was expected to lead to greater transmission of world price fluctuations into domestic markets, and thus to reduced variability in world prices. In practice, the stabilising effect of tariffication has been undermined by the practice of countries varying *applied* tariffs in response to world market price changes. An applied tariff is the actual tariff rate applied by an importing country, and may differ from the bound rate. This practice is not prohibited under the rules of the WTO provided the applied rate remains at or below the rate bound in a country's Uruguay Round schedule.

China would be likely to support any measures which would reduce its vulnerability to imported price instability. Preventing countries from raising applied tariffs (for example, when world prices fell) would be counter-productive as it would discourage countries from lowering applied rates if, *de facto*, this was taken as offering a lower bound rate. Another alternative would be to permit the use of a safeguard clause, along the lines of the Special Safeguard Clause introduced in the Uruguay Round for countries and commodities which underwent tariffication. Ideally, the use of this clause would be limited to developing countries and, perhaps, only to foodgrains under a food security opt out for developing countries. Depending on how China's status as a developing country is defined in the accession protocol, this could provide some assurance to China that domestic market stability would not be undermined by wild swings in world market prices.

Another source of potential world market price instability is that, although the Uruguay Round disciplines the use of export subsidies, its disciplines on the use of export taxes are much less strict. Article XI of GATT 1947 prohibits quantitative export restrictions but makes an explicit exception for 'export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party'. Article 12 of the UR Agreement on Agriculture tightens this a little by calling on Members, with respect to *new* restrictions on foodstuffs, to give 'due consideration' to the food security concerns of importing countries and requires adequate notice and consultation prior to implementation. Developing countries are exempt from these provisions unless they are regular food exporters. Both the US and the Cairns Group have proposed to prohibit the use of export taxes, including differential export taxes, for competitive advantage or supply management purposes.<sup>16</sup> The EU does not mention export taxes in its proposal on

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<sup>16</sup> The Cairns Group proposal is contained in WTO: G/AG/NG/W/93.

export competition, although it has used them since the signing of the Marrakesh Agreement in order to stabilise its domestic prices.<sup>17</sup> China is likely to remain a net grain importer for some time, even if the magnitude of grain imports will be smaller than earlier studies in the mid-1990s had projected. On these grounds, one could expect that China would favour any moves which would enhance the *predictability* of trade flows, and would support the strengthening of multilateral rules on export controls and taxes.

A third issue under this heading is that a high proportion of agricultural tariffs take the form of specific or mixed tariffs rather than *ad valorem* tariffs. A specific tariff is levied as a fixed absolute amount per quantity of imports; an *ad valorem* tariff is levied as a percentage amount on the value of imports. Mixed tariffs combine elements of both. The US has proposed to denominate bindings and applied rates either on a specific or *ad valorem* basis, without the use of complex tariffs or combinations of tariffs. However, it does not go as far as to propose to restrict tariffs only to *ad valorem* tariffs. Specific tariffs implicitly provide a measure of variable protection because they bear more heavily when import prices are low than when import prices are high. Specific tariffs also have a higher protective effect against lower-quality (and hence lower-value) imports than against high-quality imports. As the unit value of China's food and agricultural exports may be lower than for its competitors, the implication is that specific tariffs bear disproportionately heavier against its exports. For both these reasons, China would have an interest in encouraging more widespread use of *ad valorem* tariffs in the future.

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<sup>17</sup> The March 1999 Berlin reforms maintain the instrument of export taxes within the market management measures available under the CAP. However, it was agreed that in future their use would be restricted to a safeguard measure in cases of extreme emergency.

#### 4.1.3 *Tariff rate quotas*

An issue in the current negotiations is the future of tariff rate quotas. These were introduced to provide a guaranteed *opportunity* for market access in the knowledge that, even at the end of the Uruguay Round, agricultural tariffs would be bound at very high levels. Exporting countries are calling for some increase in tariff rate quotas to improve market access opportunities. The US, for example, has proposed that these should be substantially increased by annual increments over a fixed period and their functioning improved, including dealing with unfilled quotas. A later paper addressed the problem of unfilled TRQs, attributed by the US to poor administration and unduly high in-quota duties (WTO: G/AG/NG/W/58). The US proposes to base the reduction of in-quota duties on the historical performance of TRQ fill rates: the lower the fill rate the deeper the duty cut. An automatic trigger mechanism is suggested to reduce in-quota duties in response to falling fill rates. The EU's negotiating proposal is noticeably silent on the issue of increasing TRQs. However, it does propose that rules and disciplines should be defined to increase the transparency, the reliability and the security of the management of TRQs such that the concessions already granted are fully realised.

China could well ally itself with the EU on this issue. China will introduce tariff rate quotas on grain imports which will allow it to pursue its goal of 95 per cent self-sufficiency in food grains. Any further increase in these quota amounts would threaten this objective. While in a decade's time, a more industrialised China might feel more confident about relaxing this objective and relying to a greater extent on grain imports which would increasingly be destined for its animal feed sector, there are few signs that such a policy shift is being contemplated at the present time. China will therefore seek to defend its tariff rate quotas at close to current levels in the current round.

#### 4.1.4 State trading enterprises and TRQs

In addition to the size of tariff rate quotas, the negotiations will focus on the administration of these quotas and the way in which quotas are allocated to exporting countries. Various methods are in use including first-come first-served, allocation on the basis of historic market shares, auctions, licensing and imports undertaken by State Trading Enterprises (STEs). The United States has expressed concern that the activities of these STEs could act as a *de facto* market barrier and, by limiting imports, could underpin domestic prices. It therefore proposes to end exclusive import rights to allow private sector competition in markets controlled by single desk importers. The EU in its proposal is concerned about the activities of exporting STEs but does not raise the issue of importing STEs. The issue is relevant to China because it has granted monopoly import rights to STEs to administer TRQs for a limited number of commodities including wheat, maize, rice, cotton and oilseeds.

In fact, WTO figures suggest that TRQs administered by STEs have a higher fill rate than other allocation mechanisms. China has already agreed under the US-China Protocol (whose terms at a minimum will be included in the WTO Protocol) that the share of private trade in TRQ trade will gradually increase over the period of its accession to the WTO. It has further agreed that where unfilled quota remains three-quarters of the way through the year, it must be offered to private traders if they can make use of it. Provided its experience of operating these rules is a satisfactory one, China may be willing to further reduce the role of its monopoly STEs in the current round. In particular, since China has agreed that private traders must be permitted to import unused TRQ, then it might support the adoption of such a general rule in the GATT (Williams, 2000).



## 4.2 Export competition

On export competition, the central features of the US proposals are to *eliminate* agricultural export subsidies, by annual reductions over a fixed period, with respect to both the value and the volume of exports; to end the exclusive export rights of STEs; and to conduct negotiations on Export Credit Programmes within the OECD. The EU's position is that it is ready to negotiate further reductions in export subsidies on condition that all forms of export subsidisation are treated on an equal footing. It wants officially supported export credits in agriculture to be covered by specific WTO rules and disciplines, strengthened provisions to prevent the abuse of food aid and, in respect of the operation of STEs, that cross-subsidisation, price-pooling and other unfair trade practices in exports should be abolished.

China will enter the WTO with no entitlement to export subsidies and thus, at first sight, would have no interest in allowing other countries to maintain them. Indeed, as an exporter of fruits, vegetables, aquatic products and intensive animal products, it may feel that it would benefit from eliminating the possibility of the use of export subsidies by its potential competitors. However, if it sees that export subsidies are paid on bulk commodities which it mainly imports and which turn the terms of trade in its favour, it might be persuaded that there are some short-term advantages in allowing other exporters to use export subsidies. It would probably be willing to include export credits within the definition of export subsidies for the purposes of the reductions (Williams, 2000).

China will be affected by any disciplines on exporting STEs to the extent that it will want to continue to channel grain exports through COFCO. China's grain marketing practices in the past have allowed COFCO to export grain with an implicit export subsidy, in that it could purchase grain at a low procurement price from farmers for sale on export markets. Now that grain procurement prices in recent years have been above world market prices, there

is little rationale to continue this practice. China will probably not have any major interest in opposing strengthened rules and disciplines in this area.

### **4.3 Domestic support**

Rules on domestic support are a further contentious issue between the US and the EU. The US proposals in this area are, first, to restrict domestic support disciplines to only two categories, 'exempt support' and 'non-exempt support'. The former of these categories corresponds with current 'green box' and the latter with 'amber' payments. In other words, the US proposes to eliminate the present 'blue box' category of support, under which most EU agricultural support payments now fall. This may be seen as a direct consequence of the 1996 FAIR Act, under which the US largely abandoned coupled deficiency payment support ('blue box') in favour of diminishing decoupled production flexibility contract payments ('green box'). Second, it proposes that non-exempt support 'be reduced to a final bound level equal to a fixed percentage of the member's value of total agricultural production in a fixed base period'. Further, it proposes 'the fixed percentage [to] be the same for all members and reductions [to] be made through progressive annual reduction commitments over a fixed period.' Thus the US wants countries starting at widely varying levels of domestic support to finish at the same level (at the end of the implementation period). Third, in a reference to the multifunctional role of agriculture, the US claims to support policies that 'address nontrade concerns, including food security, resource conservation, rural development and environmental protection.' However, it maintains that 'these objectives are best met through non-distorting means, with programs targeted to the particular concern, without creating new economic distortions, thereby avoiding passing the cost of achieving these objectives to other countries....'

The EU has proposed that the reform process should be pursued by further reduction in the Total Aggregate Measure of Support (AMS) by strengthening the rules concerning non-product-specific domestic support, and by reducing the *de minimis* clause for developed countries. It wants to maintain the concept of the ‘blue’ and ‘green’ boxes, as well as the general rules and disciplines applying to them, but is prepared to discuss the detailed rules on domestic support. It proposes that the criteria to be met by measures that fall into the ‘green’ box be revisited to ensure minimal trade distortion whilst at the same time recognising agriculture’s multifunctional role. It proposes that measures which meet important societal goals such as the protection of the environment, the sustained vitality of rural areas and poverty alleviation, food security for developing countries and animal welfare should be accommodated in the Agreement on Agriculture. It also wants specific disciplines to be applied to variable ‘amber’ box subsidies which boost export performance through providing compensation for variations in market prices. In this, it is clearly aiming at restricting the ability of the US to provide open-ended support through emergency aid packages in the future.

China has historically taxed or ‘extracted surplus’ from the agricultural sector in an effort to support industrialisation, although this situation appears to be changing. Assuming that China has not had significant domestic support in the base period means that it would have a zero total AMS ceiling on such support. This would allow domestic support to be provided only if it complied with the criteria for inclusion in either the ‘green’ or ‘blue’ boxes or, if its support fell into the ‘amber’ box, up to the *de minimis* limits. This restriction may appear unimportant, given that China has committed itself to low import protection and price support. However, one anomaly is that the *de minimis* restrictions apply on a commodity basis whereas the total AMS ceiling restriction which all developed countries face applies on an aggregated basis across all commodities. This allows developed countries potentially to

provide much higher levels of support to sensitive commodities while still staying within their AMS ceiling than China will be able to do in the future. If China has not gained full entitlement to developing country status in claiming *de minimis* exemptions for domestic support in the current accession negotiations, it will be particularly sensitive to this issue and would appear likely to support the US position. Further, as China currently makes no use of ‘blue box’ subsidies and is not likely to in the future, there does not appear to be any immediate reason why it should support the EU position on this issue.

China has a huge rural population, and rural development is very important to it. However, it is unlikely to have the budget resources to engage in direct payment programmes to its farmers, who account for 50% of the population. It will, therefore, be receptive to the argument that targeted programmes to deal with environmental issues should be the preferred means as proposed by the US. It is unlikely to see merit in the argument that multifunctionality can justify price support measures to farmers. The EU has tried to make the multifunctionality argument more attractive to developing countries by suggesting that the concept could be extended to embrace their concerns with food security. However, this argument is unlikely to be acceptable to developing countries as a group who can point out that there are alternative means of achieving this end. While China might be persuaded to support the multifunctionality argument as a way of gaining concessions of more interest to it, the concept would appear to have little immediate appeal to the Chinese authorities.

#### **4.4 SPS issues**

The EU has identified food safety as another important objective in the current negotiations. Technological innovation, the globalisation of food supply, rising living standards and greater awareness of the risks of foodborne illnesses have led the public in many developed countries to become increasingly concerned about this issue. In the Uruguay

Round trade negotiations, a new Sanitary and Phyto-Sanitary (SPS) Agreement and a strengthened Technical Barriers to Trade (TBT) Agreement were agreed to provide a set of rules to govern behaviour in this area. Although these Agreements are not part of the WTO's post-UR 'built-in' agenda, the EU and some other countries want to re-open aspects of these Agreements for further negotiation.

The key principle underlying the SPS Agreement is that countries have the right to decide on the measures they deem necessary to protect human, animal or plant life or health. However, to prevent abuse, certain disciplines are applied. Measures should be based on scientific principles, should not be maintained without scientific justification, and should not be applied in an arbitrary or unjustifiable way. While these principles work reasonably well in routine situations where the science is well-established, they are less clearcut with respect to novel risks where a scientific consensus has yet to emerge. The EU argues that food regulations must take account of the precautionary principle, which would allow countries to restrict the marketing of food which has been produced using methods where scientific evidence is insufficient or there is scientific uncertainty. This principle is recognised in a limited way in Article 5.7 of the SPS Agreement which stipulates that, if relevant scientific evidence is insufficient, members may adopt SPS measures, on a provisional basis, while seeking additional information about the risks posed by a hazard. However, this provision is more restrictive than what many consumer groups would like, e.g. the qualification by the word 'provisional'. The EU has therefore proposed that the application of the precautionary principle should be clarified. The US, on the other hand, does not favour opening the 1994 Agreement on Sanitary and Phytosanitary Measures to renegotiation. China is also likely to be cautious as it is an enthusiastic adopter of genetically-modified crops and may fear EU trade barriers against its fruit and vegetable exports if a stronger precautionary principle was adopted.

The EU has also raised the need to ensure that trade does not undermine efforts to improve the protection of the welfare of animals (WTO: G/AG/NG/W/19). When a country provides for animal welfare standards that go beyond those applied by other trading partners, it argues that consumers may not be provided with coherent information on the welfare standards to which imported products are produced, and that domestic producers may be economically disadvantaged. It has suggested a number of ways in which animal welfare concerns could be addressed, including multilateral agreements, labelling, and the payment of compensation for the additional costs of providing higher animal welfare where it can be clearly shown that these additional costs stem directly from the higher standards in question.

Most opposition to raising animal welfare concerns within the WTO comes from developing countries who fear that, in a worst-case scenario, animal welfare rules could be used to block imports from countries with lower standards and would be introduced with protectionist intent. The United States, on past experience, is also likely to view this issue with great suspicion. The EU has tried to allay developing country fears by pointing out that its concerns with animal welfare are most acute in relation to highly-intensive and industrialised production methods for poultry and pigs which is most often found in developed rather than developing and least developed countries.

China will have a view on this issue given that, in 1998, pork output in China was 46 per cent of the world total. Exports as a percentage of production are small and have been falling (from around 2 per cent of output in 1990 to less than 1 per cent in 1998). Due to quality and sanitary health standards China finds it difficult to gain access to developed country markets, and most Chinese pork exports go to Russia and South-East Asian markets. There will be export opportunities in Japan, South Korea and, eventually, Taiwan as these countries open up their livestock markets to imports under WTO rules, though these countries will be tempted to continue to protect their producers by implementing sanitary measures and

technical barriers to trade. China may fear that greater flexibility by WTO Members to restrict imports on animal welfare grounds may limit its export opportunities for pigmeat in the future.

## **5 Concluding remarks**

China's WTO agricultural offer is a strikingly liberal one which will create a strong basis for open trade. The tariff reductions for the principal products such as grains, meats, soybean oil and cotton are much larger than the reductions required by the Agreement on Agriculture. They are also a significant reduction on the schedules tabled by China at the end of the Uruguay Round, although significant out-of-quota tariff protection will still remain for food grains. The TRQs are well above the current levels of China's imports (though perhaps not of imports earlier in the 1990s). Large shares of the TRQs will be allocated to the private sector to ensure the fulfilment of these TRQs. The implementation period of the commitments is five years, the developed country limit, and only half that allowed to developing countries.

The extent of China's offer should also be assessed in the light of the counterfactual level of protection. During the 1980s, agricultural protection was frequently negative for many major commodities, with implicit import subsidies used to maintain prices for urban consumers below world prices. During the 1990s, agricultural product prices have tended to be much more closely aligned with world prices and average protection rates appear to have been, on average, very close to zero. However, there has been significant year to year variation in protection rates, particularly for grains, and domestic prices of the major grains have frequently been higher than international prices in recent years. The WTO disciplines will prevent China from following the path to ever-increasing agricultural protection pursued by other East Asian economies who started earlier on an export-oriented growth strategy.

China's likely position on the US and EU negotiating proposals as discussed in Section 4 is summarised in Table 5. On balance, China is likely to be more sympathetic to the EU negotiating position in the areas of market access, largely because of its desire to maintain its current grain import arrangements. These include tariff rate quotas, out-of-quota tariff peaks on grain imports, and the continued operation of COFCO as a state trader in grains. The EU is also likely to be more sympathetic to some form of safeguard clause for foodgrain imports. However, in the areas of export competition and domestic subsidies, China is more likely to favour the US position. However, this will be 'soft' support, arising from the fact that China itself would be unlikely to make use of any concessions in these areas rather than because it feels strongly opposed to them because of damage caused to its own agricultural sector.

**Table 5. Prospective Chinese attitude to US and EU negotiating proposals**

Policy area	US	EU
Tariff reduction - extent and structure	-	++
Protection against imported price instability		
special safeguard clause	--	+
disciplines on export controls	+	
Tariff rate quotas (TRQs)	-	+
Use of STEs to administer TRQs	-	
Export subsidies	+	-
Use of single-desk STE exporters	+/-	+/-
Domestic support		
extent of reduction	+	-
extension of 'green box' to cover multifunctional payments	+	-
continuation of 'blue box'	+	-
SPS issues		
precautionary principle	+	--
animal welfare	+	--

++ implies that China would be a strong supporter of that country's position, -- implies that it would strongly oppose, +/- implies that it would be indifferent. The absence of a sign implies that the country has not formally adopted a position on the issue.



Trade negotiations are about designing trade-offs. Understanding the strategic objectives of the other participants can lay the basis for compromises where one country agrees to support another in return for that country's agreement to support it on its sensitive issues. China will enter the negotiations with a number of strategic objectives: limiting the extension of its tariff rate quotas in order to safeguard its grain self-sufficiency objective, protecting the role of its state trading enterprises, limiting the degree to which it imports world market price volatility into its own market, lowering both tariff and non-tariff barriers to its own agricultural exports, and seeking greater flexibility as a developing country with regard to domestic support. Both the US and the EU may find it worthwhile to tailor their negotiating objectives to meet these Chinese concerns with a view to attracting Chinese support for their broader objectives. In this way, China could have a considerable influence on the outcome of the current round of agricultural trade negotiations.

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