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CHINA CAN WAIT

WTO accession deal must include enforceable labor rights, real commercial benefits

by Robert E. Scott

After rejecting a proposal to bring China into the World Trade Organization (WTO) in April 1999, the Clinton Administration is working to negotiate an accession agreement in time for the WTO ministerial meetings in Seattle later this year.[1] The proposed deal would be harmful to workers in both the United States and China, primarily for three reasons:

- *China is not yet ready to join the WTO.* Its state-controlled economic system is protectionist, exploits labor, and represses human rights. In fact, the U.S. State Department recently concluded that free and independent trade unions are not permitted in China.[2] For example, in January China sentenced two railroad workers to a labor camp simply for protesting against unpaid salaries (AFL-CIO 1999).

- *The Chinese government's trade policies deliberately target U.S. markets.* In 1998, China had a $57 billion surplus in its trade with the U.S. and a $26 billion deficit with the rest of the world. In 1997 (the last year for which detailed data exist), only 10% of China's imports came from the U.S. while more than one-third of its exports came here (IMF 1999; U.S. Department of Commerce 1999).

- *Claims of great benefits from bringing China into the WTO are based on wishful thinking.* Those who believe that the U.S. will solve its trade problems with China by bringing it into the WTO have forgotten the U.S. experience with Japan, which still has the world's largest trade deficit with the

U.S. more than four decades after it joined the General Agreement on Tariffs and Trade (or GATT, the forerunner to the WTO). Moreover, recent experience with other trade agreements as well as recent trade flows with China suggest that the U.S. trade deficit with that country is likely to double in the near future if China is allowed into the WTO. This deficit increase will result in the loss of more than 600,000 jobs in the U.S., most of them in manufacturing industries.

The WTO deal outlined by the U.S. trade representative in April would primarily benefit U.S. companies that invest in China while harming workers in both countries. Surely the United States can negotiate a better deal. We should (1) oppose China's WTO membership until China agrees to include enforceable labor rights and environmental standards as core elements of the agreement; (2) assure that the agreement delivers quantifiable commercial benefits; and (3) require that it incorporate a clearly defined multilateral mechanism for enforcement.

The rapidly growing U.S. trade deficit with China and its consequences

Since 1985, U.S. imports from China have grown 25% per year, while exports to China have grown at less than half this rate. The result is a rapidly growing trade deficit for the U.S. (**Figure 1**).[3]

In 1998, China and Japan together were responsible for about half of the U.S. deficit in merchandise trade. The rest of Asia, the European Union, and Canada and Mexico accounted for the rest.[4]

Trade flows can have important effects on the level and composition of employment and on wages in all economies. In most economics textbooks, increases in trade flows are a "win-win" proposition, based on simplifying assumptions such as full employment in all affected countries. But the effects of trade in the real economy are much more complex, and they are heavily influenced by the conditions under which trade takes place.

Rising exports usually increase employment in exporting industries, while rising imports usually reduce employment in competing domestic sectors. In addition, increasing trade with low-wage countries can have a depressing effect on the wages of production workers in high-wage countries.[5]

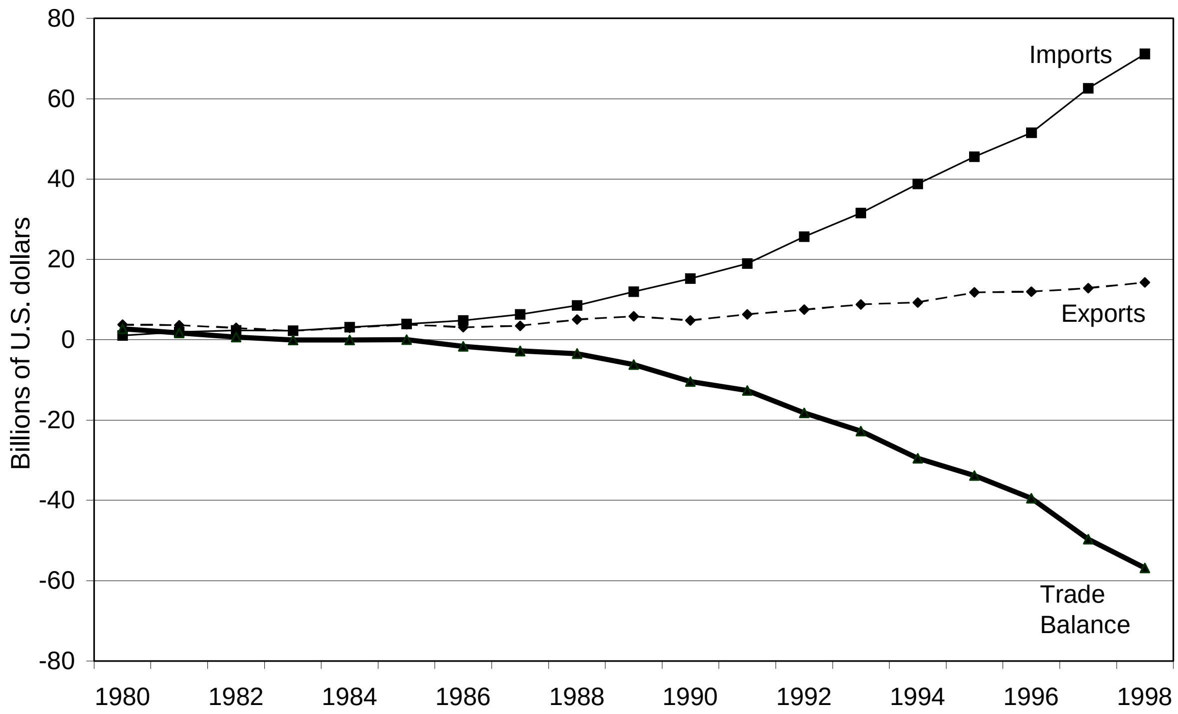
In 1996, the U.S. trade deficit with China eliminated over 600,000 jobs, most of them in high-paying manufacturing industries (Scott and Rothstein 1997b). Continuing increases in the deficit since then have destroyed several hundred thousand more jobs. Moreover, the threatened competition with workers in China, where wages are often about $1 per day, has had a chilling effect on wage negotiations in the U.S. in the 1990s.[6]

U.S. imports from China not limited to goods from low-wage industries

Promoters of China's WTO agenda typically claim that "most U.S. exports to China are high-value-added goods such as aircraft and computers," while "the job losses associated with rising Chinese exports of footwear, as well as several other important products, primarily occur elsewhere in Asia, not in the U.S." (Lardy 1999, 3-4). The numbers, however, tell another story.

FIGURE 1

U.S. Trade With China, 1980-98



Source: EPI analysis of trade data from the U.S. Census Bureau.

Table 1 summarizes all U.S. commodity trade with China in 1994 and 1998. Exports, imports, and the trade balance are summarized for six major product categories and four selected products.

The data show that the U.S. had trade surpluses (positive trade balances) with China in only two commodity groups — fuel and raw materials, and chemicals and related products – in both 1994 and 1998. The U.S. had small deficits with China in agricultural trade, but overall trade in farm products was also quite low. Meanwhile, the U.S. had large and rapidly growing trade deficits with China in all processed and manufactured commodities throughout this period. While apparel, toys, and footwear were responsible for the bulk of the overall trade deficit, the most rapidly growing imbalances were in processed raw materials and in machinery and transport equipment. China was rapidly diversifying its industrial base in this period and moving up the product hierarchy into more sophisticated goods. China's rapid penetration of higher-value-added sectors is illustrated in the bottom half of Table 1, which provides detailed information on trade flows in four important industries that are part of the broader machinery and transport equipment sector. Each of these is part of the electronics industry, and all demonstrate remarkably similar trends.

U.S. exports of each of the selected products are less than 25% of the value of imports from China. In three out of four cases, imports grew more rapidly than exports despite the small size of the export

TABLE 1
U.S. Commodity Trade With China (millions of dollars)

	Exports 1994	Exports 1998	Imports 1994	Imports 1998	Trade balance 1994	Trade balance 1998	Growth rates, 1994-98: Exports	Growth rates, 1994-98: Imports	Growth rates, 1994-98: Trade balance
Food, animals, beverages and tobacco	283	499	540	754	-257	-255	76.3%	39.6%	-0.8%
Fuels and raw materials	1,461	1,730	940	1,666	521	64	18.4%	77.2%	-87.7%
Chemicals and related products	1,508	1,973	723	1,441	785	532	30.8%	99.3%	-32.2%
Processed raw materials	408	859	3,345	6,969	-2,937	-6,110	110.5%	108.3%	108.0%
Machinery and transport equipment	5,119	8,239	9,057	21,599	-3,938	-13,360	60.9%	138.5%	239.3%
Apparel, toys, footwear and other manufactured goods	508	958	24,176	38,727	-23,668	-37,769	88.6%	60.2%	59.6%
TOTAL	**9,287**	**14,258**	**38,781**	**71,156**	**-29,494**	**-56,898**	**53.5%**	**83.5%**	**92.9%**
Selected commodities:									
Computers and parts	164	575	713	2,809	-549	-2,234	250.6%	294.0%	306.9%
Parts for computers and office machines	67	301	611	2,468	-544	-2,167	349.3%	303.9%	298.3%
Telecommunications equipment and parts	563	629	1,642	2,823	-1,079	-2,194	11.7%	71.9%	103.3%
Electrical machinery and apparatus	72	135	566	1,288	-494	-1,153	87.5%	127.6%	133.4%

Source: U.S. Department of Commerce, U.S. Commodity Trade by Country, available at http://www.ita.doc.gov/industry/otea/usfth/top80cty/top80cty.html.

base, indicating that the level of Chinese content in the final products exported to the U.S. is rising rapidly. Thus, it is more accurate and relevant to say that the U.S. exports computer *parts* to China and imports assembled computers than it is to claim that the U.S. exports computers to China. Although some high-value-added computers from the U.S. are sold there, the bulk of computer and electronics trade flows here from China, not the other way around.

The U.S. also has a large and growing trade deficit with China in phone equipment. Over the past four years, U.S. exports to China in this sector increased by just 11% while imports increased by 72%, causing the trade deficit in this sector to more than double. As in the case of computers, the U.S. exports parts and jobs to China's "export platforms" (foreign-owned factories within China that import parts and export finished goods), and it gets assembled phones in return.

This experience suggests that a WTO accession agreement will generate few if any telecommunications jobs in the U.S. As telecommunications networks are developed in China, much of the equipment will be manufactured there, and key technology will be transferred to Chinese joint-venture partners. (Such ventures are already in operation.) U.S. firms will indeed be able to sell switching software to Chinese phone companies, but since much of this software is already developed and in use in the U.S., the marginal costs (and job generation in the U.S.) of adapting it for use in China will be minimal. However, the potential profits from the sale of the intellectual property involved to a country of over 1 billion potential customers are enormous.

Unfair competition is built into China's economic system

China's success in high-tech industries such as computers and commercial aircraft is due in large part to a number of market-distorting government policies, including requirements for technology transfer to domestic firms, local content and offset requirements, and import and foreign exchange licensing arrangements. The existence of a protected home market for many important products also provides Chinese firms with a source of monopoly profits that can be used to finance new investments. It also encourages these firms to dump products in the U.S. and other foreign markets, especially in industries requiring large fixed investments for research and development, plant, and equipment (e.g., steel and semiconductors). While U.S. firms are entitled to protection from unfair competition under anti-dumping laws, they must file claims on their own behalf, and many firms participating in Chinese joint ventures may be unwilling to file claims for fear of direct or indirect reprisals that would affect their investments.

The huge and persistent bilateral trade deficit reflects the fact that fair trade with China is not a reality. China restricts imports of U.S. goods and services through a number of formal and informal trade barriers. The U.S. has negotiated several major market-opening agreements with China, including a Memorandum of Understanding (MOU) on market access and an intellectual property accord, both signed in 1992, but China has violated these and other agreements at will (UAW 1999). There is no reason to believe that, merely because it signs a WTO accession agreement, China will willingly open its markets for imports.

If China is allowed into the WTO, the U.S. will ultimately sacrifice the right to treat China as a non-market economy, making it harder to enforce U.S. laws against unfair trade practices such as the illegal dumping of low-priced steel.[7] Under the rules for non-market economies in dumping cases, the “fair” cost of production is determined by comparison with market economies at a similar stage of development, such as, in China’s case, Pakistan or India. When the non-market rules are abandoned, as required under the WTO, the U.S. Commerce Department will be forced to base its decisions on Chinese production costs, which embody extensive subsidies as well as the extremely low wages that prevail in its highly repressed labor markets.

In addition, China’s admission to the WTO will greatly limit U.S. leverage in dealing with trade problems in the future. Several times in the past six years the U.S. has used the threat of huge, punitive tariffs to compel China to abide by the terms of the 1992 MOU on intellectual property rights, and this pressure resulted in the closure of several factories that were making counterfeit compact discs. The U.S. will lose the right to use such unilateral enforcement tools against China if China is allowed into the WTO.

Trade imbalances with China reflect several underlying structural problems. First, China is following the general pattern of export-led growth established by Japan in the 1950s and 1960s. It shields its domestic industries from foreign competition while nurturing targeted domestic “pillar” industries such as motor vehicles and aircraft. Furthermore, it uses import requirements and “offset” agreements to compel firms that wish to sell products in China to transfer production and access to critical technologies to Chinese firms (IAMAW 1999; Scott 1999).

The second structural problem is the dominant role played by China’s state enterprises and the power of the state and of leading government figures in limiting market access and restricting access to foreign exchange (Lee 1999). This unique structure explains China’s pattern of repeated violation of international trade agreements and MOUs. As Quiao Shi, former head of the National People’s Congress, has noted, “China is a country of strong leaders, not strong laws” (quoted by Mastel 1999).

The questionable benefits of any WTO deal

It is frequently asserted that, because China maintains such high barriers to trade, and because the U.S. has the most open market in the world, the WTO accession agreement will have a larger impact on imports into China than into the U.S. But this assumption ignores the history of U.S. trade relations with China and other Asian countries, and it is contradicted by U.S. experience with the North American Free Trade Agreement (NAFTA) and other recent trade agreements.

Here they go again

Proponents of China’s entry into the WTO claim that it would cause U.S. exports to increase by $3 billion to $5 billion per year. According to economist Gary Hufbauer, this increase would shift up to 65,000 jobs “from other sectors of the economy” into export production, because of the reduction in barriers to U.S. imports (Hufbauer 1999).[8]

In 1998, Hufbauer co-authored an estimate that NAFTA would result in the creation of 170,000 jobs in the U.S. by 1995. The number was widely quoted to persuade Congress to approve that agreement (Lee 1995, 10-11). Following the development of a large U.S. trade deficit with Mexico after NAFTA and a large number of NAFTA-related job losses (see Scott and Rothstein 1997a), Hufbauer stated that “[t]he lesson for me is to stay away from job forecasting” (Davis 1995).

The mistake made in the NAFTA projections was that forecasters concentrated on exports, ignoring the impact of expanded trade on imports. In the case of China, looking at both sides of the ledger reveals a startling picture.

On the export side, assuming that exports to China continue to grow at the same rates as in the 1994-98 period (53.5% over four years, Table 1), and accepting Hufbauer’s assumption that WTO accession will add an additional $5 billion to U.S. exports in 2002, total U.S. exports to China will increase from $12.6 billion in 1998 to $26.9 billion in 2002. But what about imports? Inasmuch as overall trade will expand with WTO accession, we can expect imports to continue to grow at least at the current rate and exceed $130 billion by 2002, an increase of more than $59 billion. Even with the 88% increase in U.S. exports predicted above, the U.S. trade deficit with China will balloon from $57 billion in 1998 to nearly $104 billion in 2002.

Thus, the U.S. trade deficit with China is likely to increase by almost $50 billion in the next four years if China is allowed into the WTO. Using the same employment/trade relationship employed by Hufbauer, this trend would translate into a net loss of 607,000 jobs in the U.S., mostly in the manufacturing sector.[9]

Other risks: investment surges and the threat of devaluation

The NAFTA experience suggests that there are two basic risks associated with China’s entry into the WTO. First, greatly increased flows of foreign direct investment (FDI) into China will be used to dramatically expand the base of export-oriented production facilities that take advantage of large supplies of very low-wage, semi-skilled labor. It is important to note that the flow of FDI into Mexico began to surge several years in advance of the initiation of the agreement on January 1, 1994. Similarly, China has also absorbed an unprecedented inflow of FDI in the past few years. The most important consequence of the FDI surge for the U.S., under China’s current regime, is accelerated growth of imports from China.

The second risk is that China, like Mexico after NAFTA, may be forced to devalue its currency after it joins the WTO. China has already experienced some of the same fundamental economic problems that forced Mexico to devalue, such as relatively high levels of growth and inflation that could result in future current account deficits. Moreover, the U.S. insistence that China open its financial markets as part of its WTO accession agreement ignores the damage done by premature financial market liberalization in South Korea and other Asian countries (at the insistence of the IMF and the U.S. Treasury) in the recent Asian financial crisis (Lardy 1999).[10] A financial crisis in China could push China into a recession, reducing demand for U.S. exports and making Chinese goods even more competitive in the U.S. market. The consequences for the U.S. would be an additional increase in the trade deficit, resulting in even more job losses than the 607,000 mentioned above.

A new China policy

The top priority for U.S. international economic policy is the development of a global environment that is conducive to a high and rising standard of living for all Americans. In a global economy, rising incomes for American workers also depend on rising incomes for the working population of our trading partners. A strong, competitive *domestic* manufacturing base is a necessary ingredient of any strategy designed to achieve that goal. Following these principles, there are three necessary ingredients for any agreement that will safely and effectively admit China into the WTO.

First, the U.S. should oppose China's WTO membership unless and until China agrees to include enforceable labor rights and environmental standards as core elements of the agreement.

Second, the U.S. should not enter into any trade agreement with China that does not deliver quantifiable commercial benefits. U.S. exports to China should increase and the bilateral U.S. trade deficit should begin to decline within a short period. Achievement of these goals will require at least two key components: (1) China must agree to maintain or appreciate the value of its currency as needed in order to bring about the desired improvement in its trade balances (subject to waiver in the event of a financial crisis), and (2) China must agree to achieve quantifiable, numerical targets for import penetration at the product and industry level, under strict timetables (Mastel 1999).

Finally, all of these agreements must be enforceable through a clearly defined multilateral mechanism. Any changes required to make the WTO structure compatible with the necessary enforcement mechanisms would have to be put in place; these include the involvement of the International Labor Organization in certification of compliance with labor standards and the incorporation of mechanisms for the enforcement of labor agreements through trade sanctions.

The U.S. trade representative's proposed deal will not achieve these goals. The U.S. should not be afraid to walk away from negotiations if it cannot achieve these objectives now. A bad deal with China would be worse for the U.S., and ultimately worse for the world trading system, than no deal at all.

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Endnotes

1. China's admission into the WTO would require approval from a majority of the current members. In practice, though, most decisions in the WTO are made by consensus, and it is unlikely that China's entry would be approved without the support of the U.S., since it is the world's largest market and absorbs the largest share of China's exports. Congressional action would be required to provide permanent normal trade relations (or NTR, which used to be known as most favored nation) status. The Jackson-Vanek Amendment, which currently requires an annual review of China's trade status, would have to be revised. However, if the U.S. approves China's entry into the WTO, a vote on permanent NTR status will probably be delayed until 2001, after the next U.S. presidential election.

2. According to the U.S. Department of State (1999, section 6, 38), "[t]he government has attempted to stamp out illegal union activity. Li Qingxi was picked up at his home in January after he publicly posted a declaration calling for free and independent trade unions." Other examples are also provided.

3. Some analysts claim that trade with Hong Kong must be included in these calculations, since many U.S. exports to Hong Kong are ultimately destined for mainland China. However, the small U.S. trade surplus with Hong Kong declined almost 50% between 1996 and 1998, to less than $2.4 billion, versus China's 1998 surplus of $56.9 billion. Thus, inclusion of Hong Kong does not significantly alter the overall picture.

4. The U.S. had a small trade surplus with Latin America, excluding Mexico, in 1998, which offset small deficits with other regions, including OPEC (Organization of Petroleum Exporting Countries) and Eastern Europe. (U.S. Department of Commerce 1999).

5. Since exports create domestic job opportunities and imports reduce employment in domestic industries, net exports (exports less imports, or the trade balance) is the best indicator of the effects of trade on the domestic economy, holding everything else constant (Scott, Lee, and Schmitt 1997). There are a number of channels through which trade with low-wage countries can affect wages, including the elimination of high-wage jobs through trade deficits, the need to compete with cheaper products made in those countries, and the threat of plant closure and relocation (Mishel, Bernstein, and Schmitt 1999, 175-7).

6. Kernaghan (1998) reports that workers making goods for the U.S. consumer market work for as little as $0.13 per hour, as cited by Shailor (1998).

7. Provisional terms of the draft trade agreement between the U.S. and China that was under discussion in Washington in April 1998 included language that would "maintain our current anti-dumping methodology (treating China as a non-market economy) in future anti-dumping cases..." but "the duration of this provision remains under discussion" (USTR 1999, Section IV.B).

8. Hufbauer is careful to point out that the U.S. has a full employment economy, so it is really a matter of shifting jobs around, not adding new jobs.

9. Hufbauer (1999) assumes that each billion dollars of exports generates approximately 13,000 job opportunities in the domestic economy. Thus, a $5 billion increase in exports would create 65,000 domestic job opportunities in the traded goods industries. The estimate developed here applies the same ratio to imports and the trade balance. While exports may not increase total employment in an economy that is operating at full employment, it is important to note that an increase in imports or in the trade deficit that reduces the demand for labor usually results in actual job losses, not just the movement of labor from one sector to another.

10. The premature liberalization of financial markets in Asia resulted in massive inflows of short-term capital, mismatches in the term structure of assets and liabilities in recipient banks in Asia, and investments in domestic assets financed with foreign currencies that would not generate adequate amounts of foreign exchange needed to service the loans. Each of these imbalances helped set the stage for the massive outflows of short-term capital in 1997 that precipitated the crisis.

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