China-US bilateral trade deficit and implications

Major paper

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Abstract

Due to the fast grown speed and the huge volume, bilateral trade imbalance has become one of the hottest issues in China-U.S trade relations. The objectives of this paper are (i) give a detailed review on China-U.S bilateral trade deficit; (ii) discuss the magnitude of the real bilateral deficit; (iii) show the reasons for the huge amount of current U.S deficit; (iv) try to explore the arguments in the U.S for a devaluation of China's currency Yuan; and (v) discuss China's WTO entry.

China-US bilateral trade deficit and implications

I. Introduction

Developing foreign trade is critical in today's world for both developing countries and developed countries. Because trade can help both sides gain comparative advantages and therefore overall society's welfare increases. It also creates a mutual exchange, competition, higher quality goods, new technologies and helps to generate financial resources for both trading partners. Therefore, foreign trade may promote economic growth by improving resource allocation and enhancing technological progress.

Both U.S and China are important countries in this world. U.S is the only superpower left[1] and the also the most powerfully and influential country. China is the most rapidly growing economy with growth rates of 6.20% annually from 1949 to 1978 (pre-reform) and 9.62% annually after the implication of the Open Door policy (started in 1978)[2]. Great changes have taken place to its foreign trade and economic structure: China's economy has been transformed from a Soviet type economy or planned economy to a "socialist market" economy. People's standard of living increased dramatically.

The fast-developed economy improves the connections between China and mainstream countries including the U.S. Together with 1.4 billion populations, it makes China a very attractive market with great growth potentials. No doubt, China has become a major participant in the world economy. "Even though China has a per capita income that is only 1/40th of that of the United States, it is often perceived to be an emerging economic giant and a potential rival to the United States."[3]

As Chinese economy continues to grow rapidly, bilateral trade becomes more and more important in China-U.S relation. In 2004, China became the world's third-largest trading nation in and the United States displaced Japan to become China's number-one

[1] After the collapse of former Soviet Union in 1992.
[2] See Table 1.
[3] Fang and Lau (2003), page 1

trading partner[4]. Even though, bilateral trade increases dramatically in the last 2 decades, China's exportation to the U.S grows much faster than the growth of importation from the U.S, causing bilateral trade deficit (in favor of China) continue to grow. And the amount reached 201.7 billion U.S dollars in 2005 (increased from 162 billion U.S dollars in 2004), the largest trade deficit occurred with a single country in the U.S history[5]. And bilateral trade deficit has become the hottest issue in current China-U.S relations

Many U.S officials openly blamed China as the reason causing the huge current account deficit and urged China to upward revalue Yuan in order to reduce U.S. deficit. But in fact, China may be just a scapegoat for U.S. own problems. In the paper, I would like to (i) give a detailed review on China-U.S bilateral trade deficit (ii) discuss the magnitude of the real bilateral deficit; (iii) show the reasons for the huge amount of current U.S deficit; (iv) try to explore the arguments in the U.S for a devaluation of China's currency Yuan and (v) discuss China's WTO entry

II: China-U.S bilateral trade deficit

A: Brief summary of China's Economic Achievement

The People's Republic of China was formed in Oct.1, 1949. After the Second World War (20 million Chinese dead) and the following Civil War (1945-1949), the whole country was destroyed badly and the leaders were facing all kinds of difficulties. There were almost no industry and most industrial products relied on importation. In 1949, PRC's steel production was only 0.158 million tons, 26th in the world and counts only 0.1% of world total steel production[6]. In 2003[7], the country's steel production was 220 million tons, No.1 in the world and it was 1392 times more than that of 1949[8]. Agriculture production increased from 113.2 million tons in 1949

[4] The U.S-China Business Council data @ http://www.uschina.org/statistics/2005tradeperformance.html
[5] http://www.globalpolicy.org/socecon/crisis/tradedeficit/2005/0211newrecord.htm and http://www.uschina.org/china-statistics.html#us-china-trade.
[6] World population in 1950 was 2.5 billion and Chinese population was 0.54 billion or 21.6% of world population at that time.
[7] In 2003, world population was 6.38 billion and China's population was 1.32 billion or 20.7% of world population. (United Nation data)
[8] http://www.daynews.cn/mag6/20040928/ca110073.htm.

to 50,838.6 million tons in 1999 or increased 449 times. In the end of year 1949, urbanization rate was 10.64% and it was lower than that in England 150 years before (England urbanization rate was 12% in 1800). In 1999[9], over 30% of Chinese live in cities or towns. Before 1949, average life-span in China was 35 and in 1990s it reached 72. Infant death rate was reduced from 20% in 1949 to 2.67% in 1999. GDP per capita was about 100 RMB in 1949, 460 RMB in 1980 and 6,000 RMB in 1999. According to Lau (2002), before the Economic Reform in 1978, GDP per capita increased 4.6 times in 30 years but after the Reform, it increased 15 times in 20 years[10]. In real terms, Real GDP (in 2001 prices) of China was 177 billion U.S dollars and Real GDP per capita was 183 U.S dollars in 1979 and in 2001 the numbers jumped to 1,160 billion and 920 U.S dollars respectively. Within 22 years of reform, real GDP increased 6.5 times and real GDP per capita increased 5.03 times. Even though the changes are great, but comparing with real GDP and real GDP per capita of the USA in 2001, the differences are still huge. In 2001, U.S real GDP is 10,190 billion, 8.78 times of that in China and real GDP per capita was 36,840 U.S dollars, about 40 times of real GDP per capita of China.

After the establish of PRC, China recovers from the damages of constant wars since 1840s, especially after the Economic Reforms started in 1978, the Chinese economy takes-off. Table 1 presents some important economic indicators for the two periods (pre reform period 1949-1978 and reform Era after 1979). We observe: average real GDP growth rate increases from 6.20% in pre reform period to 9.62% in reform period. The average growth rate of real GDP per capita almost doubled from 4.14% (1949-1978) to 8.24% (1979-2001). The average growth rate of agriculture production increases from 4.33% for pre reform era to 7.41% for reform era. The average growth rate of light industry goes up from 7.83% before the reform to 11.23% after the reform. While the average growth rate of heavy industry slightly decreases from pre reform number 11.37% to reform period number 11.10%. Real personal

[9] In 1999, world population was 6 billion and China's population was 1.26 billion or 21% of world population. (United Nation data)

[10] Data source: http://www.cul-studies.com all data in nominal terms.

consumption and real personal consumption per capita increase from 4.99% and 2.96% in pre reform period to 9.04% and 7.70% in reform period respectively. The average growth rate of capital stock goes up from 5.93% between 1949 and 1978 to 9.83% from 1979 to 2001. The average growth rate of GDP deflator for the pre reform period is 0.59% and for the reform period the rate is 5.72. For the growth rate of retail price index, the number is 0.80% for period 1949-1978 and 6.11% for period 1979-2001.

Table.1

Average Annual Growth Rate of Selected Economic Indicators (%)		
Growth Rate	**1949-1978**	**1979-2001**
	Pre Reform	**Reform Era**
Real GDP	6.20	9.62
Real GDP/ capita	4.14	8.24
Agriculture Production	4.33	7.41
Light Industry	7.83	11.23
Heavy Industry	11.37	11.10
Real Personal Consumption	4.99	9.04
Real Personal Consumption/capita	2.96	7.70
Capital Stock	5.93	9.82
GDP Deflator	0.59	5.72
Retail Price Index	0.80	6.11

In addition, there are some other achievements that deserved to be discussed. Firstly, If we take Purchasing Power Parity (PPP) into consideration, the standard of living for ordinary Chinese could be 2 or 3 times better than that indicated by GDP

per capita. In another way, on average, U.S citizens benefit from a standard of living 10 times greater than Chinese do (since China's real GDP per capita is only $1/40^{th}$ of that of the U.S). Secondly, China is one of the few socialist countries that have successfully transformed from a planned economy to a market economy. And today, most prices are no longer controlled by government but rather by market. Thirdly, Chinese economy is no longer a shortage economy and insufficient demand appears in most industries Fourthly, China's trade volume has more than doubled in 4 years[11] (2001 to 2004) to become the 3^{rd} largest trading nation. And finally, the private sector accounts for more than 65% of GDP and even greater percentage in employment in 2001.

The success of Economic Reforms makes China a rising economic giant. Due to the rich and cheap labor resource, China has become "the world factory". Meanwhile, even income per capita of China is still low, with the large population basis (1.4 billion), PRC becomes a huge market with great growing potentials for other countries, including the USA. In the last 27 years (since 1978), China-U.S trade increased dramatically. According to Yabuki (1994), the turning point of China-U.S trade relations was the 1972 visit to China of, former U.S president, Richard Nixon. Before that the volume of China's foreign trade was very limited. Total foreign trade was about 3 to 4 billion U.S dollars in the 50s and remained at that level in 60s. One year after Nixon's visit to China, in 1973, China's total foreign trade reached 10 billion U.S dollars. And in 1978, the start of Economic Reform under Dengxiao Ping, trade volume exceeded 20 billion U.S dollars.

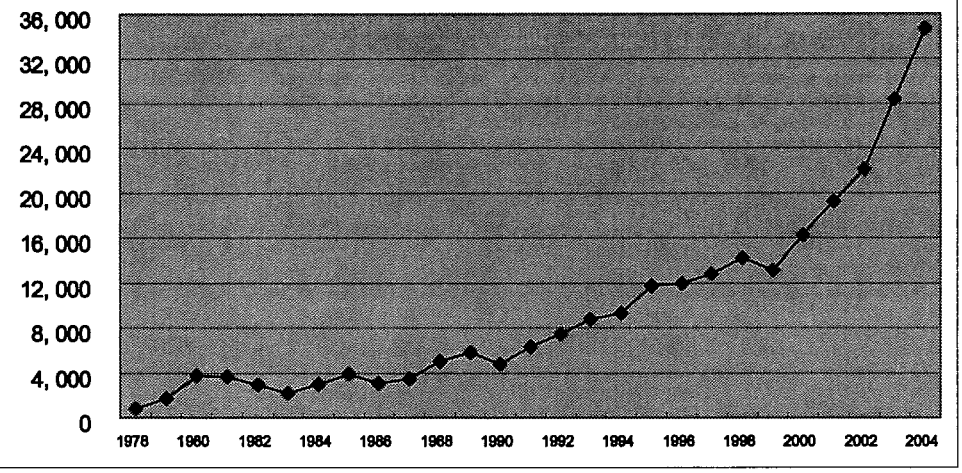
B: Detailed in China-U.S bilateral trade 1978-2004

As we see from above Figure 1 to Figure 3, China-U.S trade volume increased dramatically since 1978 and more important is the bilateral trade surplus of China.

[11] http://www.atimes.com/atimes/China/GA12Ad01.html.

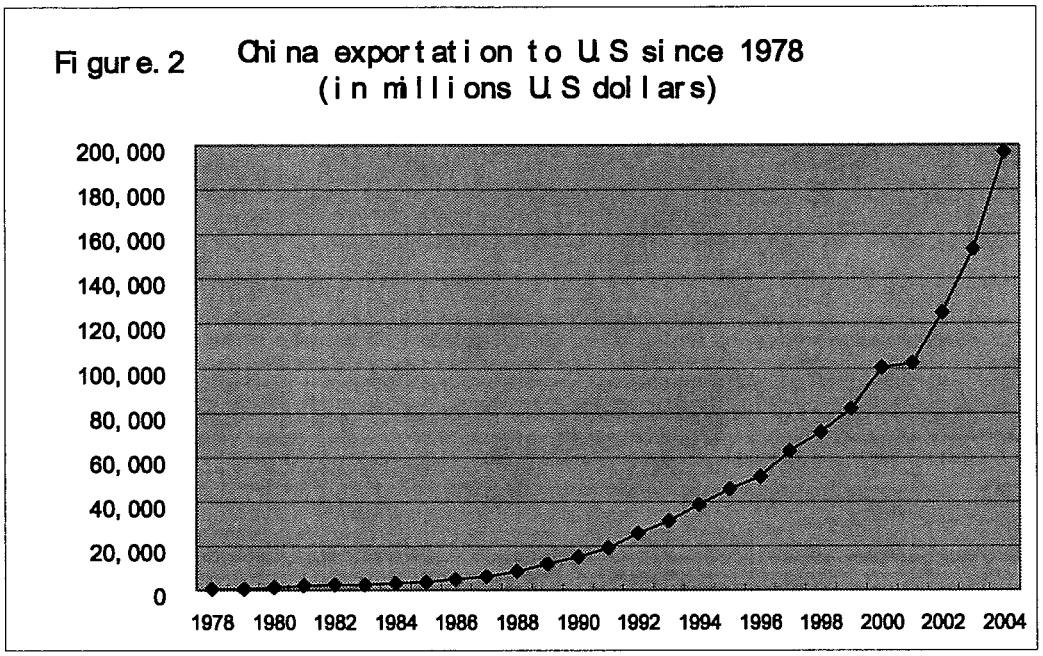
China's importation from the U.S increased from 821 million in 1978 to 3,106 million in 1986, 11,748 million in 1995 and 34,721 million in 2004. The 2004 figure is more than **40** times than that of 1978. The average annual growth rate of China's importation from the U.S is **15.49%**. Even though the growth rate of importation (from U.S) is impressing, the exportation grows even faster. China's exportation to the U.S grows from 324 million in 1978 to 4,771 million in 1986, 45,555 million in 1995 and 196,698 million in 2004. The volume of 2004 China exportation to the U.S is **607** times of that in 1978 and the average annual growth rate is **27.95%**. Because of the China's exportation to the U.S developed at a much faster speed than importation from the U.S, bilateral trade imbalance increased greatly as well (Figure 3). In 1978, trade imbalance was 497 million dollars in favor of the U.S. In 1986, it turned into 1,665 million in favor of China and the amount was 39,518 million in 1996 in favor of China. Last year (2004) the figure has grown to a historical high at 161,977 million also in favor of China[12].

Figure. 1 China importation from U.S since 1978 (in million U.S dollars)

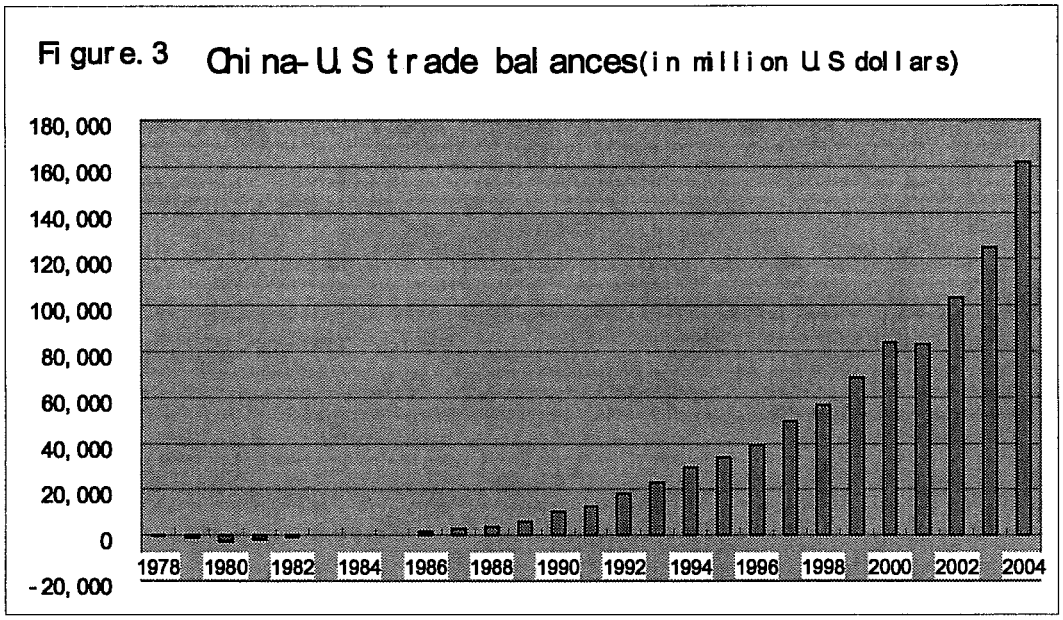


Data source: http://www.ita.doc.gov (the U.S data)

[12] Data source: http://www.ita.doc.gov.



Data source: http://www.ita.doc.gov (the U.S data)



Data source: http://www.ita.doc.gov (the U.S data)

Due to the fast grown speed and the huge volume, bilateral trade imbalance has been a critical concern in China-U.S trade relations. In the first few years after 1978, the trade imbalance between China-U.S was in favor of U.S. In 1978, U.S ran a trade

surplus of 497 million dollars with China and one year later this amount more than doubled to 1,132 million dollars. In 1980, the surplus reached the peak at 2,696 million U.S dollars and in 1982, the surplus decreased to 628 million. There were two major reasons causing the surplus: First reason is that China-U.S relations were in a honeymoon during 1970s and early 80s (At that time, China was part of the anti-Soviet Union alliance of US). After the implementation of Economic Reforms, the door for China was just opened. Due to the self-reliance policy (since 1950) and the shortage nature of Soviet type economy, lots of products were needed from living necessities to military devices (i.e. super-computers). Therefore China's importation from US increased greatly. And the second reason, on the other side, is because the Economic Reforms was just started for a few years, the outcomes were not that obvious. In another way, the export industries have not been well established and developed. As a result, even though exportation increases, import grew faster relatively.

Since 1983, the United Stated has incurred a trade deficit with China every year. Even though initially trivial in size (71 million in 1983, 61 million in 1984 and 6 million in 1985), the trade deficit grew rapidly after 1985. In 1986, it became 1,665 million, 2,796 million in 1987 and in 1990 the deficit reached 10,416 million U.S dollars. The possible reasons could be: First, in the 80s, before 1989 Tiananmen Square Incident, China still had more access to U.S market than later years (before 2001, China joined WTO) due to a strategic partnership with the America. Second reason is that the results of the development strategies (implemented in 1980s) came out to be very successful in developing exportation industries. The development strategy includes: special economic zones (i.e. Shengzhen, Hainan, Xiamen, Zhuhai), coastal open cities (i.e. Dailian, Qingdao), economic development areas not only for coastal provinces but inner provinces as well. More importantly, the central government implemented a comprehensive development plan for coastal areas, asking these regions (special economic zones, coastal open cities and economic development areas) to participate in international trade and competition in order to move forward to

market economies. For example, according to Wu (1998), when full responsibility system was introduced to all firms in external sector in 1988, exportation by these firms (in external sector) in coastal provinces alone reached 12.9 billion US dollars, about 31.7% of China's overall exports of that year. Third, some special lucrative policies towards exportation industries, such as investment subsidies, low rate loans, technology assistance and taxes advantages, also have played an important role.

After 1990, the growing rate of bilateral trade deficit slows down a little bit, but still at a very fast speed. In 1993, the deficit was 22,767 million, 39,518 million in 1996 and 83,809 million in 2000. And in the first 4 years of the twenty-first century, trade deficit between China and the U.S kept on increasing at the same speed as that in 1990s. In 2002, the deficit was 103,115 million and last year (2004) it reached a historical high at 161,977 million dollars. After the collapse of former Soviet Union, the global strategies of the United States have changed fundamentally and there was no need for China continuously to be an anti-Soviet Union partner. And together with the impacts of Tiananmen Square Incident, China-U.S trade in the early 1990s was greatly affected by non-economic factors, such as human rights, national security and so on. On one hand, Washington's tighten policies towards China reduced the U.S firms exportation to China. As a result, China imports more goods from Japan and EU. For example, Boeing Corporation loses China's orders, usually in billions of dollars, to Airbus for political reasons. On the other hand, manufacturing and assembling industries were moving from other Asian countries to China and China's exportation to U.S increases. Therefore, we observe that the scale of China-U.S trade imbalance getting bigger and bigger, especially after China joined WTO in 2001.

Table 2 China Exportation to US 1989-2004 selected categories (in millions of US dollars)

Item	1989	1990	1991	1992	1993	1994	1995	1996
Product total	11,988,535	15,223,887	18,975,798	25,675,509	31,534,834	38,781,143	45,555,432	51,495,276
84--**NUCLEAR** REACTORS, BOILERS, MACHINERY ETC.; PARTS	330,898	471,761	662,275	1,056,418	1,556,735	2,365,471	3,624,014	4,475,759
85--**ELECTRIC** MACHINERY ETC; SOUND EQUIP; TV EQUIP; PTS	1,638,009	1,926,054	2,583,044	3,431,817	4,436,294	6,522,361	7,885,601	8,907,310
95--**TOYS,** GAMES & SPORT EQUIPMENT; PARTS & ACCESSORIES	1,725,414	2,138,699	2,612,834	3,688,009	4,166,248	5,150,544	6,221,971	7,504,360
94--**FURNITURE**; BEDDING ETC; LAMPS NESOI ETC; PREFAB BD	164,475	276,169	437,636	685,833	1,109,109	1,593,106	1,979,085	2,392,587
64--**FOOTWEAR,** GAITERS ETC. AND PARTS THEREOF	720,956	1,477,406	2,532,053	3,402,557	4,519,553	5,259,130	5,823,739	6,391,558
62--**APPAREL ARTICLES** AND ACCESSORIES, NOT KNIT ETC	1,588,557	2,110,809	2,303,306	3,073,946	3,787,807	3,511,269	3,276,590	3,510,669
42--**LEATHER ART;** SADDLERY ETC; HANDBAGS ETC; GUT ART	682,988	873,922	1,177,115	1,558,587	1,940,348	2,488,387	2,536,410	2,625,240
39--**PLASTICS** AND ARTICLES THEREOF	237,083	387,256	500,311	785,141	1,069,271	1,337,725	1,623,135	1,740,912
73--**ARTICLES OF IRON** OR STEEL	181,509	223,775	254,147	294,932	337,974	429,870	555,912	666,993
61--**APPAREL ARTICLES** AND ACCESSORIES, KNIT OR CROCHET	1,068,637	1,086,288	1,131,526	1,401,062	1,509,035	1,574,307	1,376,489	1,514,853
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Product total	62,551,934	71,155,860	81,785,930	100,062,958	102,280,484	125,167,886	152,379,236	196,698,977
84--**NUCLEAR** REACTORS, BOILERS, MACHINERY ETC.; PARTS	5,992,571	7,617,468	10,174,017	13,405,756	13,717,914	20,214,882	29,902,035	43,852,568
85--**ELECTRIC** MACHINERY ETC; SOUND EQUIP; TV EQUIP; PTS	10,560,589	12,767,559	15,051,895	19,564,083	19,728,268	24,403,918	28,790,351	40,175,672
95--**TOYS,** GAMES & SPORT EQUIPMENT; PARTS & ACCESSORIES	9,364,724	10,554,986	11,079,706	12,381,730	12,215,184	14,440,857	16,104,542	17,223,771
94--**FURNITURE**; BEDDING ETC; LAMPS NESOI ETC; PREFAB BD	3,018,196	3,946,894	5,547,987	7,201,661	7,491,205	9,922,790	11,824,429	14,422,283
64--**FOOTWEAR,** GAITERS ETC. AND PARTS THEREOF	7,414,914	8,007,750	8,434,112	9,194,556	9,758,083	10,226,857	10,565,175	11,350,591
62--**APPAREL ARTICLES** AND ACCESSORIES, NOT KNIT ETC	4,161,308	3,811,343	3,750,519	4,167,042	4,152,517	4,478,787	5,489,903	6,617,924
42--**LEATHER ART;** SADDLERY ETC; HANDBAGS ETC; GUT ART	2,959,602	2,924,191	3,006,524	3,836,562	3,909,098	4,464,064	5,047,548	5,719,052
39--**PLASTICS** AND ARTICLES THEREOF	1,982,577	2,087,259	2,471,170	2,914,679	3,227,957	3,766,206	4,280,406	5,195,043
73--**ARTICLES OF IRON** OR STEEL	874,768	1,120,291	1,382,637	1,882,270	2,108,719	2,534,779	3,200,510	4,613,213
61--**APPAREL ARTICLES** AND ACCESSORIES, KNIT OR CROCHET	1,836,698	1,859,335	2,024,269	2,034,623	2,277,225	2,619,334	3,198,049	4,102,976

Data source: http://www.ita.doc.gov

Table 3 Annual increaes for selected categories of China exportation to US 1989-2004

Item	1989	1990	1991	1992	1993	1994	1995	1996
Product total	11,988,535	15,223,887	18,975,798	25,675,509	31,534,834	38,781,143	45,555,432	51,495,276
84--**NUCLEAR** REACTORS, BOILERS, MACHINERY ETC.; PARTS	nil	42.57%	40.38%	59.51%	47.36%	51.95%	53.20%	23.50%
85--**ELECTRIC** MACHINERY ETC; SOUND EQUIP; TV EQUIP; PTS	nil	17.59%	34.11%	32.86%	29.27%	47.02%	20.90%	12.96%
95--**TOYS,** GAMES & SPORT EQUIPMENT; PARTS & ACCESSORIES	nil	23.95%	22.17%	41.15%	12.97%	23.63%	20.80%	20.61%
94--**FURNITURE;** BEDDING ETC; LAMPS NESOI ETC; PREFAB BD	nil	67.91%	58.47%	56.71%	61.72%	43.64%	24.23%	20.89%
64--**FOOTWEAR,** GAITERS ETC. AND PARTS THEREOF	nil	104.92%	71.39%	34.38%	32.83%	16.36%	10.74%	9.75%
62--**APPAREL ARTICLES** AND ACCESSORIES, NOT KNIT ETC	nil	32.88%	9.12%	33.46%	23.22%	-7.30%	-6.68%	7.14%
42--**LEATHER ART;** SADDLERY ETC; HANDBAGS ETC; GUT ART	nil	27.96%	34.69%	32.41%	24.49%	28.24%	1.93%	3.50%
39--**PLASTICS** AND ARTICLES THEREOF	nil	63.34%	29.19%	56.93%	36.19%	25.11%	21.34%	7.26%
73--**ARTICLES OF IRON** OR STEEL	nil	23.29%	13.57%	16.05%	14.59%	27.19%	29.32%	19.98%
61--**APPAREL ARTICLES** AND ACCESSORIES, KNIT OR CROCHET	nil	1.65%	4.16%	23.82%	7.71%	4.33%	-12.57%	10.05%
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Product total	62,551,934	71,155,860	81,785,930	100,062,958	102,280,484	125,167,886	152,379,236	196,698,977
84--**NUCLEAR** REACTORS, BOILERS, MACHINERY ETC.; PARTS	33.89%	27.12%	33.56%	31.76%	2.33%	47.36%	47.92%	46.65%
85--**ELECTRIC** MACHINERY ETC; SOUND EQUIP; TV EQUIP; PTS	18.56%	20.90%	17.89%	29.98%	0.84%	23.70%	17.97%	39.55%
95--**TOYS,** GAMES & SPORT EQUIPMENT; PARTS & ACCESSORIES	24.79%	12.71%	4.97%	11.75%	-1.35%	18.22%	11.52%	6.95%
94--**FURNITURE;** BEDDING ETC; LAMPS NESOI ETC; PREFAB BD	26.15%	30.77%	40.57%	29.81%	4.02%	32.46%	19.16%	21.97%
64--**FOOTWEAR,** GAITERS ETC. AND PARTS THEREOF	16.01%	8.00%	5.32%	9.02%	6.13%	4.80%	3.31%	7.43%
62--**APPAREL ARTICLES** AND ACCESSORIES, NOT KNIT ETC	18.53%	-8.41%	-1.60%	11.11%	-0.35%	7.86%	22.58%	20.55%
42--**LEATHER ART;** SADDLERY ETC; HANDBAGS ETC; GUT ART	12.74%	-1.20%	2.82%	27.61%	1.89%	14.20%	13.07%	13.30%
39--**PLASTICS** AND ARTICLES THEREOF	13.88%	5.28%	18.39%	17.95%	10.75%	16.67%	13.65%	21.37%
73--**ARTICLES OF IRON** OR STEEL	31.15%	28.07%	23.42%	36.14%	12.03%	20.20%	26.26%	44.14%
61--**APPAREL ARTICLES** AND ACCESSORIES, KNIT OR CROCHET	21.25%	1.23%	8.87%	0.51%	11.92%	15.02%	22.09%	28.30%

Data source: http://www.ita.doc.gov

Table 4 averaged Annual growth rate for selected categories of China exportation to US 1989-2004

Items	Averaged growth rate
84--**NUCLEAR** REACTORS, BOILERS, MACHINERY ETC.; PARTS	39.27%
85--**ELECTRIC** MACHINERY ETC; SOUND EQUIP; TV EQUIP; PTS	24.27%
95--**TOYS,** GAMES & SPORT EQUIPMENT; PARTS & ACCESSORIES	16.99%
94--**FURNITURE**; BEDDING ETC; LAMPS NESOI ETC; PREFAB BD	35.90%
64--**FOOTWEAR**, GAITERS ETC. AND PARTS THEREOF	22.69%
62--**APPAREL ARTICLES** AND ACCESSORIES, NOT KNIT ETC	10.81%
42--**LEATHER ART;** SADDLERY ETC; HANDBAGS ETC; GUT ART	15.84%
39--**PLASTICS** AND ARTICLES THEREOF	23.82%
73--**ARTICLES OF IRON** OR STEEL	24.36%
61--**APPAREL ARTICLES** AND ACCESSORIES, KNIT OR CROCHET	9.89%

Table 5 China Exportation to US 1989-2004 selected categories (in millions of US dollars) as % of total exports

Item	1989	1990	1991	1992	1993	1994	1995	1996
Product total	11,988,535	15,223,887	18,975,798	25,675,509	31,534,834	38,781,143	45,555,432	51,495,276
84--**NUCLEAR** REACTORS, BOILERS, MACHINERY ETC.; PARTS	2.76%	3.10%	3.49%	4.11%	4.94%	6.10%	7.96%	8.69%
85--**ELECTRIC** MACHINERY ETC; SOUND EQUIP; TV EQUIP; PTS	13.66%	12.65%	13.61%	13.37%	14.07%	16.82%	17.31%	17.30%
95--**TOYS,** GAMES & SPORT EQUIPMENT; PARTS & ACCESSORIES	14.39%	14.05%	13.77%	14.36%	13.21%	13.28%	13.66%	14.57%
94--**FURNITURE**; BEDDING ETC; LAMPS NESOI ETC; PREFAB BD	1.37%	1.81%	2.31%	2.67%	3.52%	4.11%	4.34%	4.65%
64--**FOOTWEAR**, GAITERS ETC. AND PARTS THEREOF	6.01%	9.70%	13.34%	13.25%	14.33%	13.56%	12.78%	12.41%
62--**APPAREL ARTICLES** AND ACCESSORIES, NOT KNIT ETC	13.25%	13.87%	12.14%	11.97%	12.01%	9.05%	7.19%	6.82%
42--**LEATHER ART;** SADDLERY ETC; HANDBAGS ETC; GUT ART	5.70%	5.74%	6.20%	6.07%	6.15%	6.42%	5.57%	5.10%
39--**PLASTICS** AND ARTICLES THEREOF	1.98%	2.54%	2.64%	3.06%	3.39%	3.45%	3.56%	3.38%
73--**ARTICLES OF IRON** OR STEEL	1.51%	1.47%	1.34%	1.15%	1.07%	1.11%	1.22%	1.30%
61--**APPAREL ARTICLES** AND ACCESSORIES, KNIT OR CROCHET	8.91%	7.14%	5.96%	5.46%	4.79%	4.06%	3.02%	2.94%
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Product total	62,551,934	71,155,860	81,785,930	100,062,958	102,280,484	125,167,886	152,379,236	196,698,977
84--**NUCLEAR** REACTORS, BOILERS, MACHINERY ETC.; PARTS	9.58%	10.71%	12.44%	13.40%	13.41%	16.15%	19.62%	22.29%
85--**ELECTRIC** MACHINERY ETC; SOUND EQUIP; TV EQUIP; PTS	16.88%	17.94%	18.40%	19.55%	19.29%	19.50%	18.89%	20.42%
95--**TOYS,** GAMES & SPORT EQUIPMENT; PARTS & ACCESSORIES	14.97%	14.83%	13.55%	12.37%	11.94%	11.54%	10.57%	8.76%
94--**FURNITURE**; BEDDING ETC; LAMPS NESOI ETC; PREFAB BD	4.83%	5.55%	6.78%	7.20%	7.32%	7.93%	7.76%	7.33%
64--**FOOTWEAR**, GAITERS ETC. AND PARTS THEREOF	11.85%	11.25%	10.31%	9.19%	9.54%	8.17%	6.93%	5.77%
62--**APPAREL ARTICLES** AND ACCESSORIES, NOT KNIT ETC	6.65%	5.36%	4.59%	4.16%	4.06%	3.58%	3.60%	3.36%
42--**LEATHER ART;** SADDLERY ETC; HANDBAGS ETC; GUT ART	4.73%	4.11%	3.68%	3.83%	3.82%	3.57%	3.31%	2.91%
39--**PLASTICS** AND ARTICLES THEREOF	3.17%	2.93%	3.02%	2.91%	3.16%	3.01%	2.81%	2.64%
73--**ARTICLES OF IRON** OR STEEL	1.40%	1.57%	1.69%	1.88%	2.06%	2.03%	2.10%	2.35%
61--**APPAREL ARTICLES** AND ACCESSORIES, KNIT OR CROCHET	2.94%	2.61%	2.48%	2.03%	2.23%	2.09%	2.10%	2.09%

Data source: http://www.ita.doc.gov

Table 2 shows the annual amount of Chinese top-10 categories of merchandise exported to the U.S. And we observe that exportation of all these categories increased greatly. Table 3 shows the annual growth rate for each category and we find the annual increases are almost all positive for each category except category 62—Apparel articles and accessories (not knit). Table 4 shows the averaged annual growth rates for these 10 selected categories during 1989 to 2004.

Table 5 shows the share of each selected category of China exportation to the U.S from 1989 to 2004. The darkened numbers are top five categories of merchandise export to U.S each year. **In 1989**, category 95: Toys, Games and Sports Equipments, has the largest share (14.39%) of total exportation to the U.S. The second export merchandise is category 85: Electric Machinery at 13.66% and category 62: Apparel articles (not knit) is in the third place at 13.26%. Category 61: Apparel articles (knit) and category 64: footwear (etc.) are in the forth and fifth position at 8.91% and 6.01% respectively. **In 1995**, category 84: nuclear reactors and parts replaces category 42 leather art to the top fives. And in 1998, category 94: furniture becomes the fifth (5.55%) by replacing category 62: Apparel articles (not knit) (5.36%). **Since 1998**, top five merchandises export to the U.S do not change, but their relative shares do. Category 84: nuclear reactors and boilers increases its share from 10.71% (forth position) in 1998 to 22.29% (first position) in 2004. Even though category 85: electric machinery drops from the largest export merchandise in 1998 to the second largest in 2004, its relative share increased from 17.94% in 1998 to 20.42% in 2004. The share of category 95: toys, games and sports equipment drops almost a half from 14.83% (second place) in 1998 to 8.76% (third place) in 2004. The share of category 64: footwear, gaiters etc. declines from 11.85% (third place) to 5.77% (fifth place).

In the past 15 years, as shown above, the weight of labor-intensive products---footwear, toys and apparel articles in China's exportation to the U.S have decreased a lot, meanwhile the share of more value added products---electric machinery and nuclear reactors (boilers) have increased dramatically. In the early years of economic reform era, China's exportations mainly rely on labor-intensive manufacturing and assembling industries. Through the success of economic

development, more and more capital and technologies, together with modern ways of administration and operation of enterprises, flow into Chinese economy and help the development of China's national industries. Meanwhile, due to the rich and cheap labor resources, China has become the manufacturing and assembling center of the world. And industries producing more value-added goods, i.e. electric machinery, have grown faster than labor-intensive industries, like footwear, toys and etc. This trend is a sign of a thriving economy and indicates Chinese firms and products are competing with those from the US in more and more fields. For example, December 2004, China's largest PC manufacturer Legend Corporation announced acquisition of IBM's PC Department. After overcome series of difficulties and obstacles, especially US government assessment, the take-over was finished in May 2005 with a total price of 1.75 billion U.S dollars. In the past 27 years, due to the success of economic development, China has closed the gap with the United States in almost every field, especially in technology aspect. Technological progress and cheap labor costs are the key reasons for Chinese products to capture more and more shares of the U.S market.

No doubt that the U.S trade deficit with China is enormous and still growing at a very fast speed[13]. But in order to find out the actual scale of the deficit and the real impacts on the U.S economy, there are some other points need to be considered.

C: The accuracy of the data

As we know, for China- U.S bilateral trade deficit, there are huge discrepancies between Chinese data and U.S data. For example, in 1989, the U.S government estimates a trade deficit of 7 billion dollars with China while China's estimate is 3.45 billion dollars in favor of the U.S. In 1995, the U.S figure shows bilateral trade imbalance is 36.77 billion dollars in favor of China, but China' figure is just 8.62 billion dollars. In 2002, according to the U.S government, the U.S trade deficit with China is 103.1 billion. However, according to Chinese government the deficit is 42.8 billion. Most people believe that the U.S data is

[13] See appendix 1 for more information.

more accurate, since, as a transitional developing country, China lacks of resources to gather accurate data. But in fact, for China-U.S trade, even the U.S importation and exportation data has serious problem. In the past ten years, Larry (1994), Huang and Broadband (1998), Frazier (1998) and Fung and Lau (1998, 1999, 2003) have attempted to figure out the causes and the real amount of China-U.S. bilateral trade deficit. In summary of these papers, there are four major sources causing the large discrepancies of China-U.S trade balances.

The first and foremost reason is the large volume re-exports though Hong Kong. "Entities take legal procession of the goods and then re-export to somewhere else. Therefore the goods have to clear customs in Hong Kong and Hong Kong government maintains custom data on re-exports[14]". Meanwhile China is both the major source and market for Hong Kong re-exports. For China-U.S. trade, according to Dropsy (2001), the amount of Hong Kong re-exports of U.S. goods to China is almost 30% of total exportation of U.S. goods to China. Vice versa, the amount of Hong Kong re-exports of Chinese goods to the U.S. is about 40% of total exportation of Chinese goods to the U.S. The large quantity of Hong Kong re-exports and different treatment of re-exports by U.S. and Chinese statistical department accounts for the most of the discrepancies.

The second reason for the large discrepancies of bilateral trade deficit is re-exports make-up. Re-exports make-up refers the price increases by Hong Kong middleman before goods to be re-exported. This markup should be attributed to Hong Kong and need to be taken away from both China and the U.S trade data. For example, China exports 10 dollars of goods. 5 dollars worth of goods export directly to the U.S and the rest 5 dollars goods goes to Hong Kong. Chinese custom records export 5 dollars goods to the U.S. and export to Hong Kong 5 dollars goods. Hong Kong re-exports the 5 dollars goods to the U.S. with a 20% markup (worth 1 dollar) for 6 dollars. In this case, China custom records 5 dollars of exports to the U.S, while the U.S custom records 11 dollars of imports from

[14] Fang and Lau (1998), page 34.

China. And within the 11 dollars imports for the U.S, 10 dollars imports are actually from China and the rest 1-dollar imports are markups for Hong Kong re-exporters. Obviously, the U.S custom should not record the 1-dollar worth markups as importation for China.

The third reason is the U.S. and China statistical department do not measure importation and exportation on the same basis. (1) The U.S. exports data are recorded on an F.A.S basis (freight along side) while China measures exportation on an F.O.B. (freight on board) basis. The F.A.S. method does not include costs of loading goods onto transportations (planes or vessels). Therefore F.A.S basis value is less than F.O.B value and the difference is about 1% between the values measured by two bases[15]. (2) The U.S. imports are measured on C.I.F. (cost, insurance and freight) basis, while China's imports are measured on F.O.B. basis. On average, the value of the goods using C.I.F. basis is about 10% more than the value of the goods measured using F.O.B basis. In short, comparing with the measures used by China, the U.S. underestimates the value of its exports and overestimates the value of its imports.

The fourth reason is the trade in services. The above China-U.S. bilateral trade deficits are merchandise trade deficits, which do not include trade of services. And we all know, the U.S. is very competitive in service industries and is traditionally a net exporter of services. According to Lau (2002)[16], in 2001, U.S. actually runs a modest surplus with China in services trade, about 2.3 billion dollars, or 3% of the U.S merchandise trade deficit with China in that year. And the U.S overall trade deficit (including both merchandise trade deficit and service trade deficit) with China could improve slightly (3%) according to Lau's number. After entering WTO in 2001, China's services markets (banking and insurance) open up gradually, the U.S services surplus with China should increase, and therefore the overall trade deficit (services trade included) should be reduced even further.

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[15] According Fang and Lau (1998) and Dropsy (2001).
[16] Lawrence J. Lau "The Chinese Economy in the Twenty-First Century" June 16, 2002

Huang and Broadbent (1998) estimate the real balances of China-U.S bilateral trade between 1979 and 1995[17]. In 1995, the U.S official deficit with China is 33.807 billion U.S dollars[18] and according to Huang and Broadbent, the adjusted trade deficit for the U.S is 20.6 billion U.S dollars, which indicates the U.S overestimates trade deficit with China around 39%. According to Frazier (1998), for year 1995, the adjusted the U.S. trade deficit with China is 22.28 billion U.S dollars, which indicates the U.S. official data overestimates the deficits by 34%. On average between 1988 and 1997, the U.S official data overvalued trade deficits with China by about 37%[19]. According to Fang and Lau (2003), the adjusted trade deficit for the U.S in 1995 is 16.9 billion U.S dollars, which indicates the U.S data overstates the deficit by 50%. And for period from 1995 to 2002[20], the U.S data, on average overvalues China-U.S bilateral trade deficits by 36 %. Some other economists also find similar results, like Lardy (1994) and Feenstra, Hai, Woo and Yao (1998). From the literate, we conclude that the U.S data overestimates trade deficits with China and that the scale of the overvaluation of the deficits is very large.

D: Impacts of Foreign Direct Investment (FDI)

FDI in China increases dramatically since the Open-Door policy implemented in 1979. There are two major reasons for investing in China: (1) is the enormous supply of literate and healthy labors who are willing to work for very competitive wages. Low costs of labor help manufactures to gain competitive advantages. (2) the Chinese market itself which is characterized by huge population, large private savings, rising incomes, high economic growth, and a strong preference for foreign brand names.

Table 6 provides data of total FDI in China and U.S direct investment in China from 1979 to 2004. From Table 6, we observe: Total contracted FDI (contract value of the investment) is 32.36 billion U.S dollars in ten-year period from 1979 to 1989. In

[17] See appendix 3 for details.
[18] http://www.ita.doc.gov
[19] see appendix 4
[20] see appendix 5

1990, China's total FDI is 6.60 billion U.S dollars and one year later, in 1991, the amount almost doubles to 11.98 billion U.S dollars. In 1992, China's contracted FDI more than quadrupled to 58.12 billion U.S dollars. In 1993, total contracted FDI again almost doubles from the 1992 amount to 111.44 billion U.S dollars. The sharp increases of contracted FDI in 1992 and 1993 are primarily due to Deng Xiaoping's inspection tour to South China in Jan. 1992, during which the Chinese leader delivered a series of speeches to clarify China's future direction----continuing and deepening the economic reforms, and these speeches greatly raise foreign investors' confidence in investing in China[21]. After 1993, contracted FDI starts to decrease, especially after the Asian Financial Crisis (1997). In 1995, the contracted FDI is 91.28 billion U.S dollars; the amount decreases to 51 billion U.S dollars in 1997 and 41.22 in 1999. Since 2000, the contracted FDI starts to recover quickly; the number is 82.77 billion U.S dollars in 2002 and reaches all-time high at 153.47 billion U.S dollars in 2004. Total utilized investment (actually being invested) increases fast and steadily from 1979 to 1997. In 1990, utilized FDI is 3.41 billion U.S dollars and it goes up to 33.77 billion U.S dollars in 1994 and in 1997, the amount is 45.26 billion U.S dollars. Due to the impact of Asian Financial Crisis, China's utilized FDI decreases slightly to 40.32 billion U.S dollars. After year 2000, utilized FDI starts to grow again, from 40.72 billion U.S dollars in 2000 to 60.63 billion U.S dollars in 2004, which is 3.3 times of utilized FDI for period 1979-1989.

The share of U.S investment in China's total FDI (measured using contracted values) is 12.20% from 1979 to 1989, which is higher than later years in early 90s. This is because, during this period, China is viewed as a strategic partner for the U.S against the former Soviet Union and under this background, supported by U.S government, many U.S corporations, i.e. aircraft manufacturer McDonnell Douglas (acquired by Boeing in 1997), starts to invest in China. But after the collapse of

[21] Because of the collapse of former Soviet Union, Chinese people, not only normal people but also the leaders of the country, were all wondering which way would China take in the future---continuing existing reforms or coming back to the planned economy (before 1979). Deng's inspection tour to South China, at the crucial juncture of China's reforms and open-door policies (1990-1992), sets up and clarify China's direction in the future.

former Soviet Union, more importantly the Tiananmen Incident in 1989, China-U.S relationship has cooled off, as well as the U.S investment in China. The share of U.S investment in China's total FDI decreases from 12.20% (1979-1989) to 4.60% in 1991. After 1993, the U.S share starts to recover to 7.3% in 1994, 9.68% in 1997 and 14.59% in 1999. Since 2000, the U.S share of China's FDI starts to decrease again, from 12.83% in 2000 to 7.93% in 2004.

Table 6: FDI in China (total and U.S) from 1979 to 2004

Year	Total Foreign Direct Investment			U.S Direct Investment			Share of
	No. of Contracts	Amt(billion) Contracted	Amt(billion) Utilized	No. of Contracts	Amt(billion) Contracted	Amt(billion) Utilized	U.S Contracted Investment
1979-89	21,776	32.36	18.47	959	3.59	1.73	12.20%
1990	7,273	6.60	3.41	357	0.36	0.46	5.40%
1991	12,978	11.98	4.37	694	0.55	0.32	4.60%
1992	48,764	58.12	11.01	3,265	3.12	0.51	5.40%
1993	83,437	111.44	27.52	6,750	6.81	2.06	6.10%
1994	47,549	82.68	33.77	4,223	6.01	2.49	7.30%
1995	37,011	91.28	37.52	3,474	7.47	3.08	8.20%
1996	24,556	73.28	41.73	2,517	6.92	3.44	9.44%
1997	21,001	51.00	45.26	2,188	4.94	3.24	9.68%
1998	19,799	52.10	45.46	2,238	6.48	3.90	12.44%
1999	16,918	41.22	40.32	2,028	6.02	4.22	14.59%
2000	22,347	62.38	40.72	2,609	8.00	4.38	12.83%
2001	26,139	69.19	46.85	2,594	7.51	4.86	10.85%
2002	34,171	82.77	52.74	3,363	8.20	5.40	9.91%
2003	41,081	115.07	53.51	4,060	10.16	4.20	8.83%
2004	43,664	153.47	60.63	3,925	12.17	3.94	7.93%

Source: the U.S-China business council website @http://www.uschina.org/statistics/fdi_cumulative.html

FDI plays a very important role in China's economy, especially in exportation industries, bringing capitals, technology, modern administration and information. To a certain degree, we can say that China's exportation industries are fueled by foreign direct investment. According to Fang and Lau (1996), FDI (foreign direct investment) accounted for 45% of China's export. When the products made by these foreign direct investment firms are exported, China Customs record the exportation. But in fact, 45% of the profits made through exportation are not captured by China; instead they are captured by foreign firms and usually transferred back to their own countries.

The HDD (Hard Drive Disk) industries could be a perfect example for this issue. According to Naughton (2000), in 1998, U.S imported about 600 million dollars of hard drives from China and exported only a few million worth of HDD to China, therefore U.S ran a trade deficit around 500 million dollars with China in HDD industry. However, the story is much more complex. (1) All these hard disks exported from China to U.S are made by U.S firms, so some of the revenues accrue to U.S firms (2) None of the major components of HDD is produced in China. That means China only does the assembling job and captures a small portion of total value of HDDs, including wages, overhead and some of the transportation costs. A generous approximation of China's share of total value added of hard drives is at most 10 percent. Most shares of total value added comes from research, design and marketing which is done in United States. According to various estimations, U.S firms at least earn 60 percent of total value added of HDD. Based on the above estimations, for these 600 million worth HDDs exported to U.S, Chinese citizens only earn about 60 million U.S dollars while U.S citizens earns 360 million U.S dollars.

III: Reasons causing the huge trade deficit with China

Due to the large scale and increasing growth speed of China-U.S bilateral trade deficit, in the past few years, many U.S government officials and specialists have openly blamed Chinese government policies (such as China's currency policy, trade policy and WTO compliances), as the major causes of the deficit. However, the trade deficit widens, not because of China's trade barriers, not because of cheap Chinese goods dumping on the U.S. market, and not because of lack of competitiveness of the United States goods on Chinese market, but likely because of underlying macroeconomic conditions in the United States.

First of all, a nation's total trade deficit is equal to the difference between national investments and national savings. For the U.S., there is a shortage of national savings to finance national investments. The shortfall in U.S. domestic saving tends to draw an inflow of foreign saving (seeking maximize returns) to invest in the U.S. As a result, there is a financial inflow into the U.S. that leads to a trade deficit.

In addition, from national accounts aspect, it is an identity that domestic production in an economy must equal total spending plus the trade balance. Therefore, the cause of current U.S. trade deficit could be viewed as U.S. total spending exceeds its total domestic productions.

Moreover, from **Twin Deficit Identity:**

Domestic Private Saving + Trade Deficit = Private Investment + Public Budget Deficit

We observe that, other things equal, when public sector deficit increases, trade deficit increases as well. And in the past few years, according to U.S government data, the U.S. public budget moved from a surplus of 236 billion dollars or 2.4% of GDP in 2000 to a deficit of 427 billion dollars or 3.5% of GDP in 2005 (mainly due to spending on Anti-Terrorism War, tax cutting and higher oil prices). To finance the public sector deficit, the U.S has to borrow abroad which hurts trade balance (imports more than exports).

Furthermore, for China-U.S. trade imbalance, there are a few specific reasons. (1)

China has comparative advantage over the U.S. in labor-intensive products. And the WTO entrance in 2003, allows Chinese goods have more access to the U.S. market and to a certain degree, enhances this comparative advantage over the U.S. (2) China is also a relatively new member of the global economy and its exports (in per capita data) are growing from a very small base. (3) Foreign direct investments by U.S, as well as U.S. trading partners, particularly Japan and the Asian tigers (Hong Kong, Korea, Singapore, Taiwan), have been shifting labor-intensive production to China and, in effect, transferring part of their trade surplus with respect to the U.S to China. "Quite staggeringly, in 2004 foreign-invested enterprises in China accounted for 57 percent of the country's total exports, up from just 15 percent in 1990. As a result, it should come as no surprise that China's rapidly rising share of world merchandise exports is matched almost entirely by a decline in the share of Japan, and to a lesser extent, the tigers. According to WTO statistics, between 1993 and 2003 China's share rose from 2.8 percent to 5.8 percent while Japan's share and that 4 of the tigers fell from 9.6 percent to 6.3 percent and 10 percent to 9.5 percent respectively."[22] (4) The U.S. is the most technological advanced country in this world, but due to national security reasons, many of its high-tech products are not allowed to export to China. As a result, U.S. firms lose contracts to competitors and U.S. export to China reduces.

All in all, the major causes of current China-U.S. trade imbalance seem to be not from the China's side and current U.S domestic macroeconomic conditions are likely the primary reasons. And China is just an excuse for U.S. own domestic problems.

[22] Laurenceson & Qin (2005), page 4.

IV: Exchange Rate of Yuan (RMB)

A: Political pressures in the U.S

The increasing scale of China-U.S. bilateral trade deficit has brought attention of U.S officials, specialists and especially union leaders. Many of them blame China for manipulating its currency as the major reason causing the large scale of the bilateral trade deficit, which leads to the U.S manufacturing job loses, and argue that trade sanctions should be imposed on China in order to protect U.S own interests.

For example, according to Asian labor news[23], in Sept.10, 2004, " Fed up with inaction by the Bush administration, CCC (China Currency Coalition), a coalition of 20 industrial, agricultural and service organizations and unions filed a petition with the U.S. Trade Representative that would impose trade sanctions against China, unless that country revalues its currency"[24]. According to this petition, because China fixes the exchange rate of Yuan artificially low, it has an unfair trade advantage over the United States since China undervalues its exports to the United States and creates a massive trade deficit that contributes to the loss of millions of good the U.S manufacturing jobs. The degree of Yuan's undervaluation is approximately 40 percent, which indicates that the U.S exports to China are over-priced by 40 percent, while the imports from China are under-priced by the same amount. "This is so far from a level playing field, it is almost vertical," says by AFL-CIO Secretary-Treasurer Richard Trumka[25], chairman of the Industrial Union Council. And as the petition (filed by China Currency Coalition) mentioned that this exchange rate gives Chinese goods competitive advantages over other countries' products and China's fixed exchange rate policy (fixed only with the U.S dollars until recent changes) violates WTO obligations (including the WTO prohibition on export subsidies and the IMF proscription of currency manipulation) and the U.S trade law. This petition is filed under Section 301 of the Trade Act of 1974, which allows the government to take action against countries that engage in unfair trade practices against the United States.

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[23] Asian Labor News is an online database of news about workers in Southeast Asia and China
[24] AFL-CIO @http://www.aflcio.org/issuesmanufacturing/ns09092004.cfm
[25] AFL-CIO @http://www.aflcio.org/issuesmanufacturing/ns09092004.cfm

Another example, in March 25, 2005, U.S.-CHINA ECONOMIC & SECURITY REVIEW COMMISSION (USCC) files reports as recommendations to Congress. The Commission recommends that Congress should consider "imposing an immediate, across-the-board tariff, at a level approximating the impact of the undervalued Yuan, on Chinese imports unless China significantly strengthens the value of its currency against the dollar or against a basket of currencies" in order to make China to upward revalue Yuan by at least 25% in the near future. "The United States can justify such an action under WTO Article XXI, which allows members to take necessary actions to protect their national security. China's undervalued currency has contributed to a loss of U.S. manufacturing, which is a national security concern for the United States.[26]"

In fact, from April 2005 to July 2005, six reports about China's exchange rate policy were filed to the U.S congress, including report from democratic congressman, Charles Schumer and republic congressman Lindsay Graham, asking the U.S congress to impose a 27.5% tariff on all goods imported from China unless China revalues Yuan.[27] " We must stay on the offensive against Chinese currency manipulation and strike on all fronts until this unfair trade practice has been alleviated," says Sen. Lindsey Graham (R-S.C.) in a statement read by a staff member at a Sept. 9 press conference (2005) in Washington, D.C. From the above examples, we see there are huge political pressures within the U.S asking Yuan to appreciate. Before discussing the impacts of Yuan's revaluation, we need to have a look at Yuan's real value and whether China manipulates or not its exchange rate.

B: The valuation of Yuan

B-1: Is Yuan undervalued at current level?

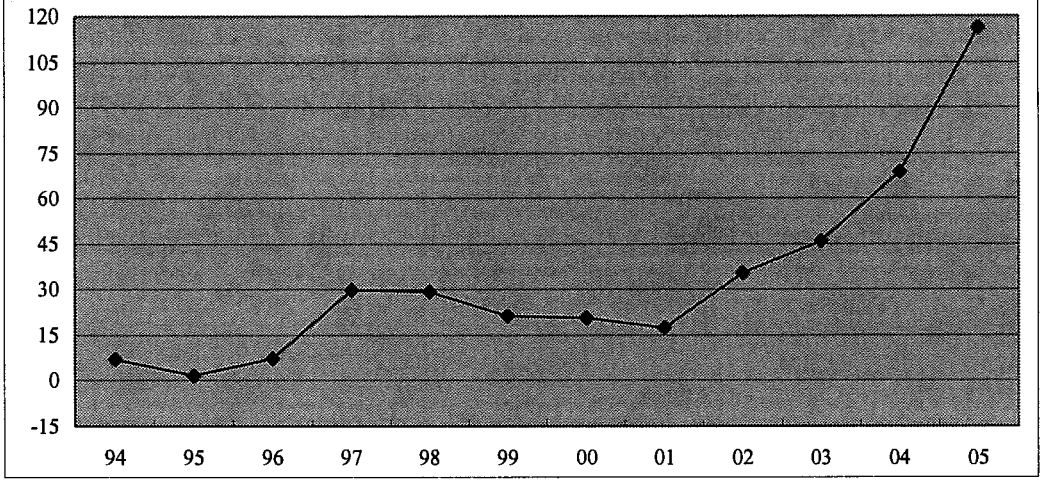
China's currency (Yuan) is fixed with U.S dollars at 1 U.S dollar=8.28 Yuan since 1994 (until July 21 2005, Yuan appreciates 2% at 1 U.S dollar=8.11 Yuan). From Figure 4, we observe that from 1994 to 2005, especially since 2001, China's

[26] http://www.uscc.gov/pressreleases/2005/05_03_25pr.htm
[27] http://business.sohu.com/20050721/n226388477.shtml

current account surpluses increase significantly, from 6.9 billion U.S dollars in 1994 to 17.4 billion U.S dollars in 2001 and 116 billion U.S dollars in 2005. During the same period, we observe in Figure 5 that China's foreign reserves also increase dramatically, especially after 2001. In 1994, China's foreign reserve was 52.9 billion U.S dollars and this number increases to 212.2 billion U.S dollars in 2001 and 818.9 billion U.S dollars in 2005. Figure 6 shows Yuan's trade-weighted real exchange rate and from 1994 to 2004, and we observe that since 2001, Yuan's trade-weighted real exchange rate has decreased by 14%[28].

Figure 4

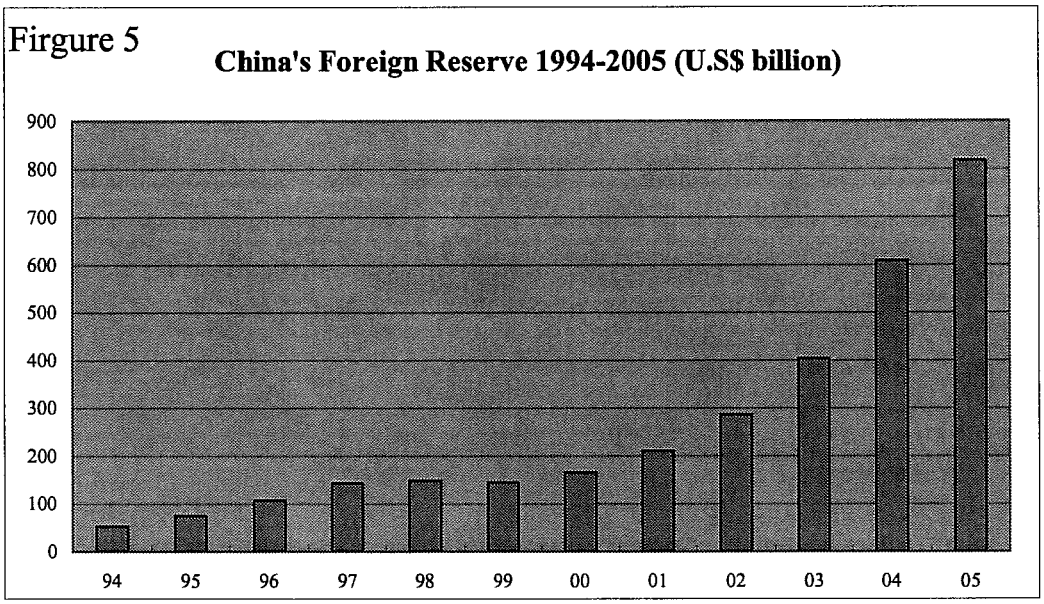
China Current Account Balance 1994-2005 (U.S dollars billion)



Source: State Administration of Foreign Exchange of the People's Republic of China

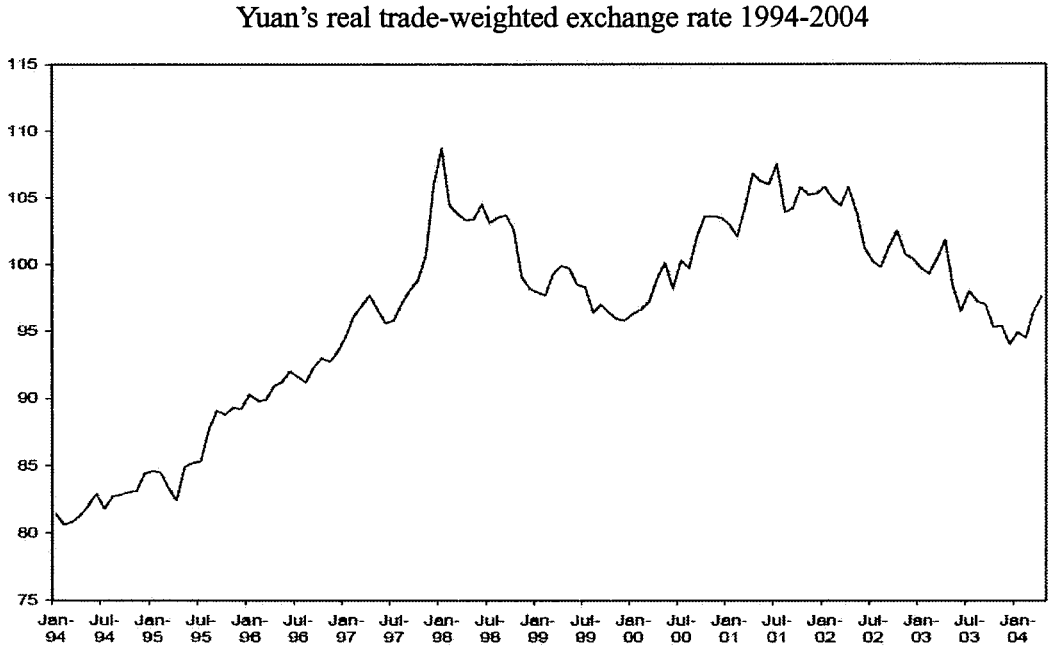
[28] Laurenceson & Qin 2005, page 7

Firgure 5



Source: State Administration of Foreign Exchange, People's Republic of China

Figure 6



Source: Morris 2004 Page 25

Many studies on the valuation of Yuan conclude that Yuan is undervalued. Williamson (2003) and Goldstein (2004) estimate that Yuan is significantly undervalued by 15 to 25 percent; Coudert and Couharde (2005), using various indicators, estimate the undervaluation of Yuan is from 18 to 54 percent; Frankel (2004) estimates that Yuan is undervalued by approximately 35%; "The Economist documents various estimates of the degree of overvaluation. The "Big Mac Index" estimates the Yuan as being undervalued at a whopping 56%; Ernest Preeg, of America's Manufacturers alliance estimates the Yuan should rise, according to market forces by 40%; the bank UBS estimates the figure at 20%. Other estimates can be as low as 10-15%"[29]. On the contrary, "Wang (2004) finds, however, that it is difficult to arrive at any firm and robust conclusion about the equilibrium level of the RMB using a variety of existing techniques."[30] Similarly Laurenceson & Qin (2005) and Keidel (2005) also conclude that little rigorous evidence found in support of the argument that Yuan is seriously undervalued.

In fact, according to Keidel (2005), there is no standard checklist (the conclusion of IMF and its methodology) in determining whether one currency is undervalued or not. And due to China's complex economic and political conditions, it is extremely difficult to find out the equilibrium of Yuan. Taking into consideration of China's growth potentials, real purchasing power of Yuan and improvement of productivity, in my opinion, Yuan is undervalued at current level. But the degree of the undervaluation is hard to know.

B-2: Has China manipulated the exchange rate of Yuan?

Scholars who believe China manipulates the exchange rate of Yuan argue that, by keeping the exchange rate of Yuan artificially low, China gains unfair competitive advantage and benefits from it. The large increase in China's foreign reserve is used as evidence supporting this argument. According to Goldstein (2005), the huge

[29] Bridgeman (2004), page 10
[30] He (2005), page 2

buildup of China's foreign reserve between 2002 and 2004[31] suggests that " there has indeed been large-scale, protracted intervention in the exchange market in one direction and this is currency manipulation."

On the other hand, according to Lachman (2005)[32], the U.S treasury currency report for the second half of year 2005 does not deem China as a manipulator of its currency Yuan. And according to Keidel (2005)[33], the investigation, which last more than a year about China's currency issues implemented by the U.S General Accountability Office, also concludes there is little evidence found in support of China manipulating its currency. Similarly in recent IMF country report on China, issued in Nov 2005, there is no mention of a serious undervaluation of Yuan and certainly no currency manipulation.

In fact, whether or not China manipulates the exchange rate of Yuan is directly tied up with Yuan's valuation. If Yuan is significantly undervalued, then we may conclude that China manipulates its currency. If Yuan is not greatly undervalued or fairly priced, then there will be no manipulation. As discussed before, I think that Yuan is undervalued, but how much it is undervalued is not known. Clearly, a more appropriate question is to what extent the revaluation of Yuan would affect current account deficit and job lost in the U.S.A. We now turn to that question.

C: Impacts of Yuan's revaluation on U.S economy

On July 21, 2005, China announced 2.1% appreciation of its currency Yuan and Yuan is no longer pegged with the U.S dollars only, but rather with a basket of currencies. Does Yuan's revaluation can help to improve U.S. current account deficit? The answer is unlikely.

According to Nanto and Lum (2006), in 2004 U.S current account deficit was 617 billion U.S. dollars, about 5.5% of U.S. GDP and the trade deficit with China was 162 billion U.S. dollars, which accounts for 26% of U.S. current account deficit.

[31] See Figure 5.
[32] Carnegie Endowment For International Peace, A luncheon Debate "China's RMB: Is It Seriously Under-Valued And Unfairly Manipulated?" Dec 8, 2005 Washington, D.C
[33] Same as note 28

Assume a more drastic revaluation than most China critics are calling for, say 50%, could only reduce U.S. current deficit by around 10% and current account deficit is still at 5% of GDP which is much higher than needed level (2%-3% of GDP) to achieve long-run sustainability (Kouparitsas, 2005; Roubini and Setser, 2004). Even if China-U.S trade deficit drops to zero, U.S. current account deficit is still more than 3% of GDP and in the long run, which suggests that sustainable current account deficit could not be achieved, in the U.S.

Former Federal Reserve Chinaman, Alan Greenspan's opinion is that the revaluation of Yuan would not help to reduce U.S overall trade deficit[34]. This is because, without the changes of U.S. macroeconomics conditions, the demand for these imports remains. According to Moore 1996; Prusa 2001; Bown 2004, past experience suggests that restrictions on U.S. imports from China are more likely to divert U.S. demand toward other low-cost foreign suppliers than toward domestic import-competing industries. Similarly, Pieter Bottelier argues: "Deficit with China does not stem from unfair trade practices by the Chinese. It is not harmful to U.S economic interests. On the contrary, the United States derives more benefit from its trade with China than from its trade with many other counties. Reducing the trade deficit with China through discriminatory import restrictions against China or a revaluation of Yuan would probably not reduce the overall U.S current account deficit, but rather divert import demand to other foreign suppliers"[35] These results indicate the revaluation of Yuan will have limited impact on U.S job loss problems in import-competing industries and will not improve U.S. current account deficit. If the goods are not imported from China, they will be imported from other countries. Therefore, the valuation of Yuan will not help the U.S to reduce overall trade deficit and improve current account deficit.

"Indeed, research suggests that the probable result of selective trade policies is the reduction of national and world well-being without a significant effect on the

[34] http://business.sohu.com/20050521/n225650904.shtml
[35] Pieter Bottelier (2004), page 3

overall trade balance."[36] In China-U.S trade case, similarly, on China Economic Summit 2005, Nobel Price winner, Robert Mundell says " It is quit wired and rarely happened in history, that when one country's (the U.S) economy is in trouble, it starts to put another country (China) pressure to revalue its currency (Yuan)...Currently, it is not a good time to greatly revalue Yuan and the revaluation of Yuan will hurts both China and U.S. Economies.[37]" This is because, for China, as the economic growth is led by exportation, the revaluation of Yuan will hurt China's export and reduces economic growth rate. For the U.S, the revaluation of Yuan will help little on the U.S. current deficit problem, as well as job-loss of import-competing industries. Clearly the U.S consumers have benefit from cheap Chinese imports and the revaluation of Yuan will lift up prices of Chinese imports, therefore makes the U.S customers worse-off. The revaluation of Yuan will also harm the interests of the U.S invested firms in China, the slow down of China growth caused by Yuan's revaluation will also decrease China's importation, thus hurts the U.S exports industries.

The revaluation of Yuan may not help to improve U.S economic conditions. Rather, the current exchange rate obtained by Chinese government, to a certain degree helps the U.S to stabilize the trade deficit with China. It is because, Yuan is fixed with the U.S dollar and when the U.S dollar depreciates against world major currencies (i.e. Euro), and then Yuan depreciates against these currencies as well. Therefore, the lower value of Yuan stimulates China's exportation to other markets, like EU. Between 2002 and 2004, the EU trade deficit with China more than doubled, compared with the U.S trade deficit with China which increased by a little over one half (WSJ, 17/05/2005).

China's currency issue may also be part of a strategy of the U.S government on other issues. For instance, by asking Yuan to be revalued, the U.S government may indirectly forcing China to reform its whole financial and banking systems.

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[36] Bown, Crowley, Mcculloch and Nakajima (2005),page 4
[37] http://business.sohu.com/20050525/n225691125.shtml

D: The Plaza Accord---a lesson from Japan

Looking back into modern economic history, we could find many lessons related with currency problems to be considered seriously by the Chinese government.

Among all of these lessons, perhaps there is no better example than the appreciation of Japanese Yen in late 1980s. According to 'Plaza Accord' signed in Plaza Hotel, New York, Sept 1985, by ministers of Finance and central bank governors of the U.S, Japan, France, Western Germany and Britain, the central banks of these five countries would intervene currency market by selling U.S dollars in order to let U.S dollar to depreciate, because in 1984, U.S incurred large current account deficit of 100 billion dollars and government deficit of 145 billion dollars[38]. After the 'Plaza Accord', Japan adopted floating exchange rate policy and by letting U.S dollar to depreciate, Yen was forced to appreciate. Yen appreciated more than 100 percent from 1 U.S dollar=250 Yen in 1985 to 1 U.S dollar=120 Yen in 1987. The appreciation of Yen reduced Japanese firms' competitiveness and forced firms to shift production overseas. This caused job losses in Japan and reduced domestic demand. Therefore in order to stimulate investment and domestic demand, central bank of Japan had to lower interest rate from 4.5% (Jan 1986) to 2.5% (Feb, 1987). Meanwhile, international speculation capitals flowed into Japan, buying Japanese stocks and real estates, pushing Yen to appreciate even further. As more and more investments shift into real estate industry and stock market, sending Japan's real estate and stock prices sky-high. In 1989, before the bubble exploded, Tokyo stock index was at an all time high 38,957 (reached under 8000 in 2003 and in July 31 2005, it was 11899) and the land prices of Tokyo alone equals total land prices of whole U.S. After 1990, real estate companies and financial institutions, including commercial banks began to bankrupt, sending Japan's economy into a recession lasting almost 10 years. Even today, Japan's economy is not fully recovered from the damages done by the recession in 1990s. Plaza Accord and appreciation of Yen are among the major factors behind Japan's recession[39].

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[38] http://www.globalpolicy.org/socecon/crisis/2003/deficittable.htm

[39] Focus.com news Jun 24,2005 @http://house.focus.cn/newshtml/113053.html

E: Economic Impacts of the Revaluation of Yuan on China

China has to take the currency issue quite seriously for internal reasons. For instance: "The weightiest argument is that a more liberal capital account regime fosters the development of deep and liquid spot and forward foreign exchange markets, which in turn are needed for banks and firms to hedge their foreign exposures. Banks have currency mismatches on their balance sheets, according to this argument, which they have to be able to hedge in order to protect themselves from volatility. Foreign investment enterprises and domestic enterprises assembling imported components similarly have foreign-currency-denominated obligations. Absent adequate hedging opportunities, an increase in exchange rate volatility could be destabilizing for both the financial and industrial sectors."[40]

Even though Economic Reforms have been implemented for more than 25 years, fewer changes have taken place in financial and banking system. Sequential changes must be made, if exchange rate policy changes. And this process could be very risky and dangerous. The main risk to the banks is the danger of export growth will slow sharply due to revaluation of Yuan. As China's economic growth relies heavily on exportations,[41] the slow down of exportation will slow down China's economic growth. "Slower growth will make for more nonperforming loans, and slower export growth will make for more nonperforming loans in the export sector. A substantial (double-digit) appreciation of the Yuan might have had this effect, given the relatively low (single-digit) profit rates in the export sector."[42]

China runs a consistent and large scale of trade surplus with U.S and has a foreign reserve of more than 853 billion U.S dollars (by Feb, 2006)[43]. According to Shen (2005), due to expectation of Yuan to appreciate, about 120 to 150 billion US dollars "hot money" flows into China and invested in real estate and stock markets.

Even though, China may benefit from a more flexible exchange regime, because

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[40] Eichengreen (2005), page 10

[41] In year 2005, exportation attributes to more than 30% of GDP growth. Chinese Academy of Social Sciences report " China's Economic Situations: Analysis and Forecasts" Dec.2005 Page 3

[42] Eichengreen (2005), page 12

[43] According to China's Prime Minister Wen Jiabao's speech at Australia, Apr.3, 2006 @ http://www.yangtse.com/pub/yzweb/xwpd/cj/t20060404_59133.htm

increase in monetary independence will help China to maintain macroeconomic stabilities, the change of exchange rate would also generate some concerns:

Firstly, if Yuan starts to appreciate, the anticipations of further appreciation will lead more "hot money" flow into China. According to Chief economy of CSFB (Credit Suisse First Boston) Asian department, Tao Dong (2005), in the second day after Yuan's 2 percent upward revaluation, there were about 1 billion US dollars flowed into China and in NDF (Non-Deliverable Forward) of Yuan, people are expecting Yuan to upward revaluate by 4.53 percent (verse current 2 percent) in one year.

The inflows of the "hot money" will push real estate and stock prices higher. The higher prices of real estate and stocks will give "hot money" that seeks maximizing profit more incentives causing more "hot money" inflows. "Economist Robert Mundell in his works about international monetary policy, proposes an ' impossible trinity' that states that a country cannot have all three of the following: 1) a fixed exchange rate, 2) free capital movement, and 3) an independent monetary policy."[44] China has chosen to peg Yuan to the U.S. dollar, to have an independent monetary policy and to have strict restrictions on the flow of capital[45]. The more the "hot money" inflows, the more the pressure on the sustainability of China's current exchange rate policy[46] and therefore the more the likelihood of changes toward more flexible exchange policy, which indicates further appreciation of Yuan.

Secondly, the appreciation of Yuan could lift up price levels, reducing the competitiveness of Chinese goods over foreign products. According to India Economic Times, May 23,2005, due to the coming of China's revaluation of Yuan, the supplier of fabric products of the world's largest retail giant, Wal-Mart, will shift manufacturing plants from China to India. This is because: when Yuan appreciates[47],

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[44] See footnote 53

[45] In recent years, especially after China's entrance of WTO, liberalization of financial markets is under process and Chinese government starts to loosen restrictions. Domestic individuals have more freedom in access of foreign exchange. And foreign firms have been allowed to conduct financial services (insuring and banking) in China. These changes allow international "hot money" to have more excess into China.

[46] Because of the large economic scale, China cannot afford not to have an independent monetary policy.

[47] In July 2005, Chinese government announced a 2.1 percent revaluation of Yuan and Yuan is no longer pegged with the U.S dollar, rather a basket of currencies, which allows Chinese currency to float more freely

China's total production (Y) will decrease because of the reduction of exportation (causing by higher exchange rate). On the other hand, because China still keep fixed exchange rate regime and only allow a small appreciation of Yuan[48], people would anticipate further appreciations, leading to a lower risk premium, which implies a fall of nominal interest rate and an increases of investment. And an increase of investment will increase aggregates demand and lift up domestic price levels. When large scale of "hot money" flows into China seeking to maximize profit, it increases China's money supply and lifts up price levels. The increase of China's domestic price levels will lead costs of productions to go up (as inputs prices rise), therefore reduces competitiveness of Chinese goods, causing a further reduction in exportation.

Thirdly, the revaluation of Yuan could reduce Chinese firms' profit margin and add more pressure on employment that is already troublesome[49]. According Wang (2005), a finance expert at a Shanghai business school: "Many small and medium-size businesses that rely on low value-added goods and competition over low prices will be sent to the wall, creating hundreds of thousands of unemployed... even a revaluation of just 3 percent would reduce Chinese textile exports by 30 percent."[50]

Fourthly, the change of the exchange rate of Yuan will make China less attractive to Foreign Direct Investment that has played an important role of economic growth in some part of China. As Yuan appreciates, investing in China becomes more expensive and this discourages FDI in China[51].

Fifthly, the revaluation of Yuan would worsen Chinese commercial banks' bad debts. According to Chinese economist Fan (2003), Chinese commercial banks' bad debt to GDP ratio was about 40%, which is probably the most in the world. The major reason for this extremely high ratio of bad debts is that, forced by government,

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[48] On July 21, 2005, China announced an appreciation of 2.1% of Yuan.

[49] "Research by RAND indicates that when proper allowance is made for "disguised" rural unemployment as well as 'unregistered' urban unemployment, China's actual unemployment rate soars to an estimated 23% of the total labor force", Charles Wolf, 2004.

[50] Buckley (2005), page 1

[51] FDI and "hot money" are different. FDI is related to investment activities and directly contributes to the development of economy, forming new business and creating more jobs. On the other hand, "hot money" is related to speculating activities and not directly contributes to the growth of economy.

commercial banks have to finance state-owned enterprises in order to let them survive. The loan is granted not based on financial fundamentals but on government policies. And most of these loans are not used for production related purposes rather they are used to cover operating expenses. The appreciation of Yuan will slow down exportations and causing more nonperforming loans in export sector. What even more scary is that if the revaluation of Yuan creates real estates and stock market bubbles, like what happened to Japan in late 80s, more bad debts would be created, making already extremely dangerous bad debts problem even more serious. Quite possible, China's whole financial and banking system would collapse at that time and so do China's economy. On the other hand, more "hot money" flows into China speculating Yuan to appreciate further

Sixthly, the appreciation of Yuan could reduce Chinese incomes of rural residents. The U.S agricultural products have price advantages over those produced in China[52]. The upward revaluation of Yuan would make China's agriculture even more expensive than those imported from the U.S. Due to the lack of competitiveness of domestic agricultural products, Chinese farmers are losing domestic marketing to U.S agricultural products[53]. Moreover, low labor cost is the most important factor contributing to the competitiveness of Chinese exports and most of Chinese cheap labors are from rural area. The appreciation of Yuan will hurt China's export industries and will cause job losses of rural workers, and therefore reducing rural labors income. From the above two aspects, the revaluation of Yuan could hurt Chinese farmers' interests, reduce farmer's income and cause deflations in China's rural areas.

Seventhly, the revaluation of Yuan, if not being handled well, could possibly delay the reform process of Yuan towards floating exchange regime. A country's exchange regime has to be suitable for its economic situations and the long-run success depends on whether there is a strong banking sector and sound economic

[52] China's domestic major agricultural products prices are 20-70% higher than international prices of those products in 2002. @ http://www.snhx.org.cn/zhongzi/hydt/t20040720_105987.htm

[53] In year 2005, the U.S exports to China agricultural products of 4.66 billion U.S dollars, which accounts for 11.15% of the U.S total exports to China last year. Data source TradeStats Express @ http://tse.export.gov/NTDChartDisplay.aspx?UniqueURL=n1nkfaqwojxbeo55cqpf3x55-2006-5-4-15-53-26

fundamentals. As mentioned before, as Yuan starts to appreciate, more "hot money" will come into China, putting pressures on the sustainability of China's current exchange regime, causing problems to the economy (like discussed above) and making existing problems even more complicated. If these negative impacts could not be overcome, then China's economic environment may not suit for a flexible exchange rate regime, as otherwise it could be. Therefore, potentially these problems (caused by revaluation of Yuan) could make China hold back steps towards floating exchange regime.

Finanly, the change of Yuan's exchange rate may also cause instabilities in Eastern Asian area. When Yuan appreciates, eastern Asian countries may be forced to appreciate their currencies due to increasing in current account surplus. And if China's exchange rate changes greatly, it will lead to exchange rate fluctuations in these countries and causing instabilities in financial markets.

As shown above, if Yuan is allowed to float or greatly appreciates, China's situations could be much worse than Japan's during recessions in 1990s. From lessons of Asian Financial Crisis, "Flexible exchange rates in economies with weak financial sectors and inadequate legal regimes leave economies exposed to international financial meltdowns. Without a healthy financial system, moving from a fixed to a fully floating exchange rate system can be destabilizing because a floating currency is exposed to international currency fluctuations. China's banks are weak and the country's legal and regulatory systems are arguably too immature to police and defend the financial markets adequately"[54]. Therefore Chinese officials decide to change it gradually. In July 21, 2005, China announce an 2% upward revaluation of Yuan and Yuan is not longer tied with the U.S dollar only, rather it is tied with a basket of currencies. Even though Yuan is still not completely floating (still under administration of central bank of China), as most currencies do, it is more flexible than before. This change is viewed as the first step of China's currency policy moving towards floating exchange rate regime. And perhaps the most important positive

[54] Gelb (2003), page 5

impact of the revaluation of Yuan is that Chinese government has finally started the reforms of banking and financial sector and decided to complete transformation from a Soviet type economy (planned economy) to a market economy. Even though the reforms of banking and financial sector could be painfully and costly in the short run, it should be beneficial to China's economy in the long run.

The more the Chinese economy integrated with global market, the more the need for a flexible exchange rate regime. The problem is not whether to adopt a flexible exchange rate regime, rather it is when and how to adopt it. In my point of view, right now is relatively a good time for China to begin the move towards a more flexible exchange regime, but must be in accordance with the reforms in financial and banking sector. The fast growing current account surplus, and world largest foreign reserves, will also be very useful for this change. Considering both the short-run economic backgrounds and long-run economic needs, the reforms of China's exchange rate regime should be gradual and in pace with reforms in other financial sectors. Therefore, China's recent action to slightly appreciate Yuan could be the most appropriate and practical way to take.

V: China's WTO entrance

A: Motivations and struggles

China officially applied to the General Agreement on Tariff and Trade (GATT) (replaced by WTO in 1995), in July 1986 to resume its status as an original contracting party. After 15 years of negotiations, on November 10, 2001, China's accession package was formally approved and China became the 143rd WTO member on December 11, 2001. Both China and its major trading partners, including the U.S, will benefit from the WTO entrance, which not only will enhance market excess for both sides, but also will reduce disputes and uncertainties over trade relationships. For China, its long-run strategy is to continue current reforms towards a market-based economy and to integrate into the world market, so that sustainable economic growth could be achieved in the long term. Entering the WTO shows China's determination to continue and deepen current reforms, and it is also viewed as a great step for China to integrate into the world market. On the other hand, for its major trade partners, China is definitely an attractive market, with world's largest population and highest economic growth rate. Moreover, the agreement will force China to act according to WTO rules. Directly it helps China to shape its economy towards a rule-based one. More importantly, indirectly it speeds up China's liberalization process in both economic and political systems.

It takes China 15 years of effort to join World Trade Organization, much longer time than the application process of any current WTO member. There are varieties of reasons for this. In 1986, when China applied to GATT, China's relationship with western countries was in a honeymoon. Without the Tiananmen Incident (1989) and the collapse of Soviet Union, China would have joined WTO much earlier. The Tiananmen Incident shattered China's image from a progressive country to a regressive one. The collapse of Soviet Union further undermined China's relationship with western countries. These changes not only delayed China's WTO entry, but also greatly weakened China's bargaining power in WTO negotiations. Under the new

environment, western countries asked China to give in more, for example, opening more markets to foreign firms, having more liberalization and transparency trade regimes and improving China's human rights conditions.

At the same time, China is not willing to give up too much and too quick, especially on access to domestic market and government interventions. Some Chinese officials and specialists were afraid that the transition period would not be long enough to let Chinese domestic firms to prepare, especially for SOEs (state-owned-enterprise) and Chinese commercial banks. Others worried that the competition of foreigners would kill Chinese domestic industries and cause seriously unemployment problems. For instance, it was believed that the opening of agricultural sector would hurt Chinese farmers, who are already the poorest group in China. And this would cause serious social and political consequences and makes Chinese society unstable.

B: Some milestones of China's WTO deal[55] and China-U.S specific issues

Table 7 provides a brief summary of key events of China's WTO agreement and some China-U.S specific issues. From Table 7, we observe that China's transitional period for most industries end in 2006, besides the auto sector, which transitional period ends in 2007. After 2007, most of China's domestic markets will completely open to international competitions. And any protections against WTO rules will not be allowed. China's practices in international trade must follow WTO rules. On the other hand, the U.S will remove its safeguards on textile products in 2009 and the China-specific-safeguards[56] will be removed in 2013.

[55] For more details, sector-by-sector summaries see appendix 7.
[56] Detailed information about China-specific-safeguards will be discussed in next page.

Table 7: Milestones of China's WTO deal and China-U.S specific issues

Year	Key Events in China's WTO Deal
2001	China became a WTO member on December 11
2003	100 % foreign-ownership in hotels is allowed in tourist facilities
2004	Restrictions lifted for distribution of imported goods
2005	Most tariff cuts complete; geographical restrictions on cell phones lifted;
	Most of the insurance market opened; Most banking restrictions lifted
2006	Most quotas removed; full implementation of the U.S - China trade agreement to occur
2007	Tariffs reduced to 10% in the auto sector
2009	U.S textile safeguards removed
2013	China-specific-safeguards will be removed.

Source: http://www.sinomania.com/CHINANEWS/china-wto.htm

C: Impacts of China's WTO deal on the U.S

Since the U.S. is already a WTO member and already opens its market to China by granting China **N**ormal **T**rading **R**elations, China's entering WTO will only cause few adjustments on the U.S (comparing those have to be made by China). China's entrance of WTO has given U.S. farmers, manufacturers and service providers access to a large and growing market, resulting in the rapid growth of U.S. exports to China. Moreover, the agreement allows unprecedented access to the Chinese market for the U.S in some politically sensitive sectors like banking, insurance, and telecommunications. Integrating China into the global trading system will further strengthen the economic and political reforms, which are already deeply changing Chinese society. A more open, stable and liberal China is in the best interest of the U.S. In the long run, U.S firms will benefit from trading and investing in the world's fastest growing market.

For the first 12 years after accession, in addition to the existing global safeguard provisions, China has also agreed to **a country-specific safeguard** that is stronger

and more targeted relief than that provided under current Section 201 law (allows industries and/or their workers who are facing serious injury because of increased imports to seek temporary relief from the U.S. government). This gives the US a huge advantage to take effective actions **unilaterally** to protect American domestic market from increased imports from China that cause or threaten to cause market disruption in the United States. Meanwhile, the U.S. still treats China as a non-market economy. That means, under the agreement, the U.S may use third country prices references and employ special methods, designed for non-market economies, to counteract dumping against Chinese imports.

D: Other impacts of China's WTO deal on China

The agreement will also help Chinese government deepen its current economic reforms. From the experiences other countries' economic reforms, external pressures and obligations have proven useful in countering the power of domestic interest groups that is against reforms. In the case of China, the state-owned enterprises and local protections are major forces against China's reforms towards a market economy. With the agreement, all level of governments and interest groups will act in accordance with WTO the rules and regulations. This will help China continue and deepen the country's reforms in both economic and political systems.

Under the agreement, foreign firms have much more access to the Chinese market than before, and therefore more competition. This will accelerate changes of roles of Chinese governments in the economy. By reducing government interventions, China will move further towards a market economy and Chinese people will enjoy more freedoms. For example, since China's telecommunications market (including to Internet and satellite services) are opened, Chinese people will have more accessibilities to information, ideas and debate from around the world. This will speed up China's liberal and democracy process.

In order to fulfill China's WTO commitments, the Chinese government has to publish and replace laws and regulations based on new rules----international rules. In addition, more information of trade policies will be available to public. Moreover, in the decision making process, leaders have to take international laws and regulations into consideration. These will strengthen the rule of law in China and help to stable China's external relations with the rest of the world.

Finally, the WTO agreement will help China to achieve long-term sustainable growth. We know that China's current economy is a mixed economy (changing from planned to market economy but not finished yet) and the growth is extensive growth (growth mainly relies on the amount of inputs, not technology), which is not sustainable. China's WTO membership will improve efficiency of Chinese economy by re-allocating of resources among industries and among firms. In addition, the increasing competition will force firms to be more efficient and innovative in order to survive, regardless of whether they are local or foreign, private or public. These will help China to achieve sustainable growth.

E: Impacts on China-U.S economic relationships

First of all, from Figure1 and Figure 2, we observe that bilateral trade volumes increased dramatically since China's WTO entrance. Also from Table 6, we observe that U.S direct investment in China increased from 7.51 billion U.S dollars in 2001 to 12.17 billion U.S dollars in 2004. Obviously, China's WTO deal boosted trade and investment activities between China and the U.S. I do believe that China's WTO agreement should have limited impacts on bilateral trade deficit, because before the agreement, the U.S market is already opened and China already has the same access[57]. In fact, the impacts of the agreement on bilateral trade are indirect. China's WTO

[57] In the past 20 years, China is treated as Most Favorable Nation, even though it is accessed by U.S congress each year. In term of U.S market access, there is virtually no difference before and after China's WTO entrance.

accession speeds up the shifts of manufacturing from other Asian countries to China. Most of these factories are export oriented and the U.S is a major market of these manufactures, therefore some deficits, counted in other Asian countries before the agreement have been transferred to China and become parts of China-U.S. bilateral deficit. After 2005, most Chinese services industries will be opened. And since American firms are very competitive in these areas, like banking and insurance, some improvements of the U.S trade deficit towards China are expected in the near future. The actually amount of bilateral deficit may not decrease, but the growth rate will slow down.

III. Summary

According to the U.S official data, in year 2005, bilateral trade deficit between the U.S and China reached 201.7 billion dollars, the largest deficit with a single country in the U.S. history. Even though many U.S officials blame China as the reason for the huge deficit, in my opinion, the deficit results from U.S own problems. The real reasons causing the deficit are (1) current U.S. macroeconomic conditions, mainly low saving rate and overspending in public sector. (2) shifting of manufactures from other Asian countries into China (3) According to the standard international trade theorem, each country tends to specialized in the industries they have competitive advantages. Since the U.S is more competitive in high value-added industries, i.e. high tech and services industries, resources will shift from low value-added industries, i.e. manufacturing to high value-added industries. Therefore the U.S must import more of low value-added manufacturing goods. And China is specialized and has the most competitive advantages in these manufacturing goods (4) accounting measures used by the U.S over states the true value of the deficit.

Meanwhile, U.S officials using China-U.S bilateral trade imbalance as an excuse to clamp down on China to float it currency Yuan and speed up reforms, especially in financial sectors. Because U.S. financial service is very competitive, a floating Yuan

and non-restricted capital flows in and out of China will benefit U.S firms. On the other hand, taking into consideration of lessons from Asian Financial Crisis and current China's situations----weak financial systems and lack of legal regimes, Chinese officials decided to keep fixed exchange rate regime, but Yuan is no longer pegged with U.S dollar only, rather it is pegged with a basket of currencies. Because, without a mature financial sector, transferring from fixed exchange rate regime to flexible exchange rate regime could lead to great social instabilities, which current China could not afford. Even if the transfer is successful with minor costs, without a healthy financial system and legal regime, Chinese Yuan will be exposed to international capital attacks and the Asian Financial Crisis will be repeated in China. The revaluation of Chinese currency Yuan in July 2005 is viewed as the start of moving towards a more flexible exchange rate regime and also is a sign to speed up currently undergoing reforms in financing and banking sectors. In the long run, undoubtedly China will adopt a more flexible exchange regime, so that monetary policy could more effectively steer the economy and exchange rate to be an efficient price mechanism in allocating resources, helping China to achieve sustainable economic growth. But in the short run, the weak financial systems decide that only gradual changes are to China's best interests. After July 2005, Yuan appreciates gradually from 1 U.S dollar=8.11 to 1 U.S dollar=8.02[58] (June 4, 2006) and it may continue to appreciate at a modest rate in the near future. The reforms of banking and financing sectors are focused on cleaning out bad debts; recapitalizing, reconstructing and downsizing China's big four commercial banks and adopting modern administration knowledge to improve management, efficiency and accountability. The process of its financial systems reforms determines when China will move to a flexible exchange regime. The actual amount of time to complete the process is hard to know, but it probably will take at least 5 to 10 more years and at that time, China may exit fixed exchange rate regime, by adopting a more flexible exchange rate regime.

[58] http://www.bank-of-china.com/cn/common/service.jsp

China's entry into WTO in 2001 holds the greatest promise for continuing current reforms, accelerates its integration with global markets and both China and the U.S benefit from it. As a member of WTO, China has gradually opened up its markets for goods and capital. Since 2001, China has decreased tariffs, removed trade barriers and given foreign companies equal access to markets, including its financial markets to all WTO members. As a result, China's international trades and financial transactions increased greatly in the past few years. As capital mobility increases, there are more needs to adopt a more flexible exchange rate regime, because of the incompatibility between independent monetary policy, capital mobility and exchange rate regime.

Both China's exchange rate and WTO entrance have limited impacts on the huge amount of current China-U.S bilateral trade deficit. For the future bilateral deficits, it may continue to rise in the near future, due to economic fundamentals in both countries, but the growth rate may slow down.

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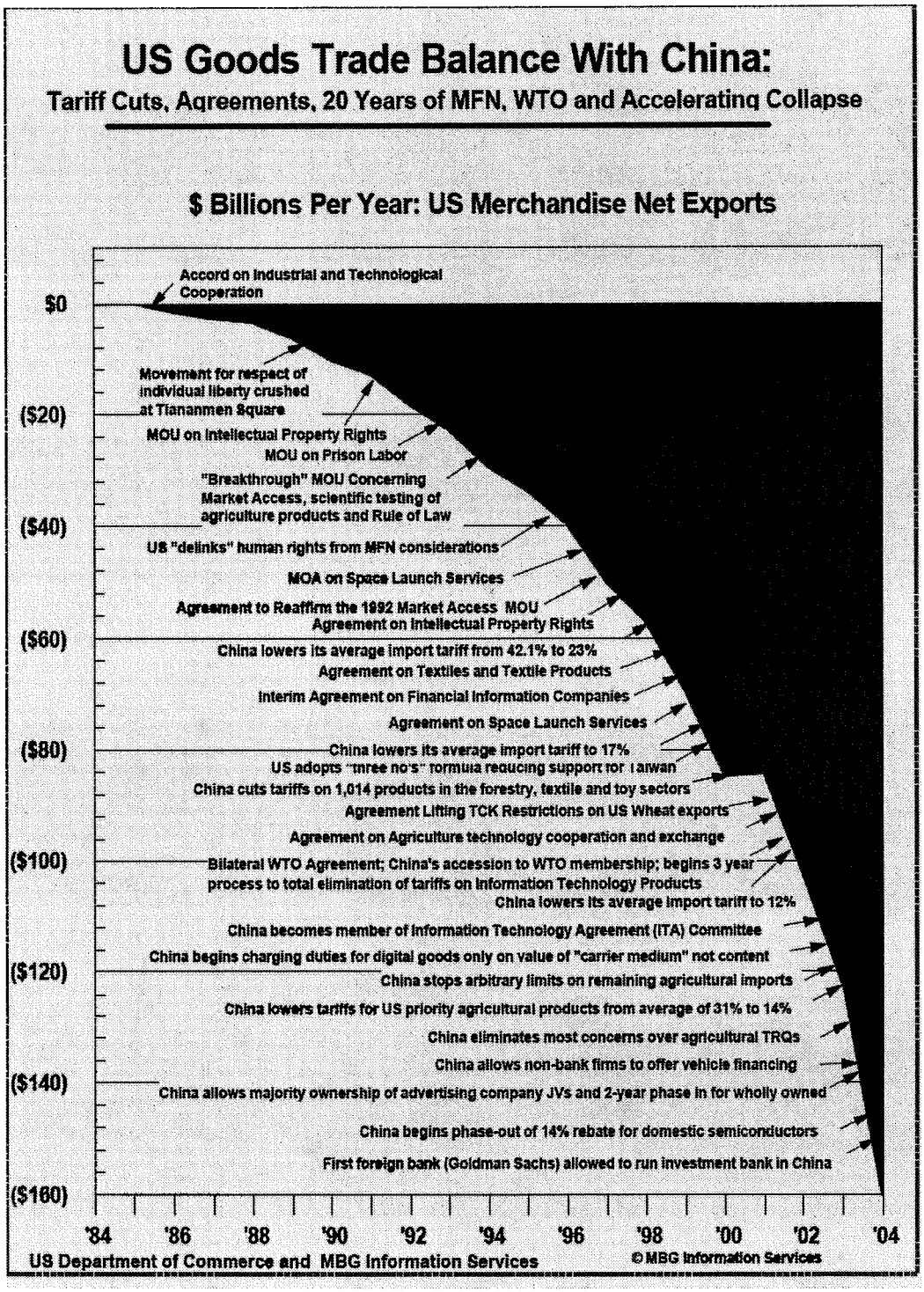
Appendix: 1



Source:http://www.uscc.gov/trade_data_and_analyses/2005/broad_economic_trade_trend/A-US-PRC-trade-agmts.pdf

Appendix: 2

Variable	Source	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999e	2000e
US EXPORTS TO CHINA													
U.S. Official Exports to China (f.a.s.)	ITA	$5.8	$4.8	$6.3	$7.4	$8.8	$9.3	$11.8	$12.0	$12.9	$14.2	$13.1	$16.0
U.S. Official Exports to China (f.o.b. = f.a.s.+1%)	ITA	$5.9	$4.8	$6.3	$7.5	$8.9	$9.4	$11.9	$12.1	$13.0	$14.4	$13.2	$16.2
U.S. Adjusted Exports to China (f.o.b.)	Huang-Broadbent	$7.6	$6.3	$8.3	$9.4	$10.8	$13.1	$15.5	#N/A	#N/A	#N/A	#N/A	#N/A
U.S. Adjusted Exports to China (f.o.b.)	Lardy-Frazier	$7.0	$6.0	$7.8	$9.6	$11.7	$12.8	$16.5	$17.5	$18.4	#N/A	#N/A	#N/A
U.S. Adjusted Exports to China (f.o.b.)	Fung-Lau (extended)	$6.9	$5.9	$7.8	$9.5	$11.5	$12.6	$16.2	$17.2	$18.1	$18.9	$17.7	$21.6
U.S. Adjusted Exports to China (f.o.b.)	CHELEM	$7.1	$6.1	$7.9	$9.6	$11.6	$12.7	$16.4	$17.4	$18.4	$19.0	$17.8	$21.8
U.S. Adjusted Exports to China / U.S. Official Exports to China		121.8%	126.2%	125.5%	129.9%	132.8%	136.9%	139.3%	145.3%	142.7%	133.7%	136.1%	136.3%
H.K. Re-Exports to China													
H.K. Re-Exports of U.S. Goods to China (f.o.b., before markup)	Fung-Lau	$1.3	$1.3	$1.7	$2.4	$3.2	$3.7	$5.0	$5.9	$6.0	$5.3	$5.2	$6.4
H.K. Re-Exports of U.S. Goods to China / U.S. Adjusted Exports to China (%)		18.4%	21.5%	21.6%	24.9%	27.5%	29.1%	30.5%	33.9%	32.7%	27.8%	29.1%	29.4%
Markup for U.S. Imports Re-exported to China (%)	Fung-Lau & Frazier	13.0%	11.3%	9.3%	9.3%	7.8%	5.7%	5.6%	6.2%	6.2%	6.2%	6.2%	6.2%
US IMPORTS FROM CHINA													
U.S. Official Imports from China (c.i.f.)	ITA	$12.0	$15.2	$19.0	$25.7	$31.5	$38.8	$45.5	$51.5	$62.6	$71.2	$81.8	$100.6
U.S. Official Imports from China (f.o.b. = c.i.f.-10%)	ITA	$10.9	$13.8	$17.2	$23.4	$28.7	$35.3	$41.4	$46.8	$56.9	$64.7	$74.4	$91.5
U.S. Adjusted Imports from China (f.o.b.)	Huang-Broadbent	$9.8	$12.3	$14.8	$19.7	$21.9	$31.1	$36.1	#N/A	#N/A	#N/A	#N/A	#N/A
U.S. Adjusted Imports from China (f.o.b.)	Lardy- Frazier	$10.4	$13.4	$16.2	$21.5	$25.9	$32.5	$38.7	$44.0	$54.5	#N/A	#N/A	#N/A
U.S. Adjusted Imports from China (f.o.b.)	Fung-Lau (extended)	$8.9	$11.4	$14.0	$18.7	$22.6	$28.4	$33.9	$38.8	$48.2	$56.1	$65.5	$81.1
U.S. Adjusted Imports from China (f.o.b.)	CHELEM	$10.7	$13.7	$16.9	$22.9	$28.4	$35.0	$41.6	$47.1	$57.3	$65.4	$77.0	$95.0
U.S. Adjusted Imports from China / U.S. Official Imports from China (%)		89.1%	90.0%	89.1%	89.1%	90.1%	90.2%	91.4%	91.4%	91.5%	91.9%	94.1%	94.4%
H.K. Re-Exports to U.S.													
Re-Exports of Chinese goods to U.S. (f.o.b., before markup)	Fung-Lau (extended)	$8.5	$10.5	$13.4	$18.1	$21.8	$25.3	$27.6	$29.2	$31.3	$31.1	$32.2	$37.5
H.K. Re-Exports of Chinese Exports to U.S. / U.S. Adjusted Imports from China (%)		79.5%	76.7%	79.3%	79.0%	76.7%	72.3%	66.3%	62.0%	54.7%	47.6%	41.8%	39.5%
Markup for Chinese Imports Re-exported to U.S. (%)	Fung-Lau & Frazier	19.0%	17.4%	20.5%	22.9%	26.1%	24.9%	24.7%	25.6%	25.6%	25.6%	25.6%	25.6%
US TRADE BALANCE WITH CHINA													
U.S. Official Trade Balance with China (f.a.s.)	ITA	-$6.20	-$10.40	-$12.69	-$18.31	-$22.78	-$29.51	-$33.79	-$39.52	-$49.70	-$56.93	-$68.68	-$84.65
U.S. Adjusted Trade Balance with China (f.o.b.)	CHELEM	-$3.63	-$7.62	-$9.02	-$13.29	-$16.78	-$22.29	-$25.25	-$29.68	-$38.90	-$46.35	-$59.15	-$73.19
U.S. Adjusted Trade Balance with China / U.S. Official Trade Balance with China		58.6%	73.3%	71.1%	72.6%	73.7%	75.5%	74.7%	75.1%	78.3%	81.4%	86.1%	86.5%

Source: Vincent Dropsy, "China's Accession to The WTO, Real Exchange Rate Changes and their Impact on U.S. Trade with Greater China" East Asian Bureau of Economic Research in its series Trade Working Papers with number 181.

Appendix: 3

Adjusted China-U.S. Trade Balances 1979-1995

	New estimates: Chinese surplus	Chinese version Chinese surplus	US version US deficit
1979	− 1170	− 1262	− 1068
1980	− 2699	− 2847	− 2591
1981	− 2062	− 3177	− 1541
1982	− 1187	− 2540	− 410
1983	− 42	− 1040	304
1984	− 293	− 1524	377
1985	− 938	− 2863	368
1986	586	− 2085	2135
1987	1469	− 1806	3413
1988	954	− 3234	4244
1989	2273	− 3450	7094
1990	6000	− 1277	11489
1991	6526	− 1812	14018
1992	10247	− 304	19943
1993	11071	6343	22416
1994	18008	7444	32075
1995	20589	8621	36772

Source: C.D. Huang and Broadbent 1998, "Do the figure add up" International Review of Applied Economics, Vol. 12 NO. 1 1998.

Appendix: 4

U.S. Official deficits and Adjusted Trade deficits

	Official Data			Adjusted Data		
Year	Exports	Imports	Trade Deficit	Imports	Exports	Trade Deficit
1988	5.033	8.512	3.479	7.626	6.089	1.537
1989	5.807	11.989	6.182	10.381	6.952	3.429
1990	4.807	15.224	10.417	13.4	5.978	7.422
1991	6.287	18.976	12.689	16.234	7.84	8.394
1992	7.47	25.676	18.206	21.535	9.6	11.935
1993	8.767	31.535	22.768	25.856	11.699	12.157
1994	9.287	38.781	29.494	32.472	12.784	19.688
1995	11.748	45.555	33.807	38.737	16.451	22.286
1996	11.997	51.513	39.522	44.031	17.496	26.535
1997	12.805	62.552	49.747	54.548	18.396	36.152

Source: Frazier, Mark, "Understanding the U.S.-China Balance of Trade", the United States-China Business Council, Sept, 1998 @ www.uschina.org/public/wto/balancing_uschina_trade.html

Appendix: 5

Estimate of U.S.–China trade balance, f.o.b., adjusted for re-exports, re-export markups and services (billion US$)

Year	Our estimate of U.S. imports from China f.o.b. adjusted for re-exports and re-export markups (official U.S. data)	Our estimate of U.S. exports to China f.o.b. adjusted for re-exports and re-export markups (official U.S. data)	Estimate of U.S. exports of services to China (official U.S. data)	Estimate of U.S. imports of services from China (official U.S. data)	Our estimate of U.S.–China trade balance of goods and services (official U.S. data)
1995	33.7	16.0	2.5	1.7	−16.9
1996	38.7	17.1	3.2	1.9	−20.3
1997	48.2	18.0	3.6	2.2	−28.8
1998	56.3	18.9	4.0	2.3	−35.7
1999	65.1	17.7	3.9	2.7	−46.2
2000	80.3	21.4	4.6	2.8	−57.1
2001	83.5	24.7	5.3	3.0	−56.5
2002	104.0	27.4	5.3	3.0	−74.3

Source: K.C.Fang and Laurance. Lau Journal of Asina Economics 14(2003) P491

Appendix: 6

China's WTO Implementation as of May 2004

USCBC Member Priority*	PRC Action Since Fall 2003
1. Trading rights	Foreign Trade Law granting the right to import and export issued April 2004; Implementing Regulations circulated for comment.
2. Transparency	Minimal improvement with exception of 1) Ministry of Commerce (MOFCOM) provisional regulation issued November 2003 on administrative transparency for all MOFCOM rulemaking and resulting routine release of draft laws for comment; 2) impending implementation of Administrative Licensing Law.
3. Distribution	Regulations issued April 2004; implementing regulations to come.
4. Standards, technical regulations, and conformity assessment	Effort to rationalize standards system by eliminating outdated, irrelevant standards; partially successful effort to reconcile CCC mark requirements and HTS category conflicts; slow implementation of new CCC mark regime.
5. IPR: Enforcement	Commitment to improve consultations and overall enforcement at April 2004 US-China Joint Commission on Commerce and Trade meetings.
6. Nontariff measures (quotas, licenses, tendering requirements)	Better administration of 2004 auto quota; resolution on blocked genetically modified soybean imports; impending implementation of Administrative Licensing Law.
7. Tariffs	With the exception of certain agricultural goods, natural resources, and products under quota or license management, all imported goods reached their final bound duty rate on January 1, 2004.
8. Specific market access commitments	*Auto finance*: Rules governing auto-financing activities by nonbank financial institutions issued December 2003; high capitalization requirements. *Banking*: Foreign banks permitted to offer RMB services to Chinese enterprises on schedule. *Securities*: Ahead of schedule—Rules issued in 2002 permit foreign investors to take up to 33 percent interest in joint ventures underwriting A shares and underwriting and trading B and H shares. Rules issued before December 2004 deadline increase the permitted level of foreign ownership in securities joint ventures to 49 percent. *Insurance*: China has permitted foreign insurers to expand into cities as required by WTO agreement but maintains excessive capitalization requirements and imposes ambiguous branching requirements.
9. Nondiscrimination/national treatment	Discriminatory value-added tax treatment on semiconductors; US brought case to WTO in early 2004.
10. Customs and trade administration	Customs has cooperated with other PRC government authorities and foreign companies to resolve standards, IPR issues in 2003–04.
11. IPR: Legal framework	Chapter in new Foreign Trade Law affirms PRC government's right to take legal action against imported pirated goods (no comment on exported pirated goods).

* In order of importance to USCBC members as determined by 2003 USCBC survey on members' priorities regarding China's WTO implementation (http://www.uschina.org/public/documents/2003/09/wtosurveysummary.pdf)

Source: 2004, The US-China Business Council

Appendix: 7

Detailed information of China's WTO Agreement[59]

(i) Agriculture

The average tariffs of the US agricultural products were cut from 31.5% (pre-agreement) to 14.5% at the end of year 2004 as the following table. China will expand access for bulk agriculture commodities, such as corn, cotton, wheat, rice and soybean oil. Also China will eliminate export subsidies (critical for US cotton and rice products) and for the first time ever China will permit private trade in agriculture products[60]. In the last couple of years, due to the agreement, the amount of US agriculture products exported to China increased significantly. For example, category 12:oil seeds etc, export to China more than doubled from 1,031 million US$ in 2001 to 2,371 million US$ in 2004. For category 52:cotton including yarn and woven fabric, exportation to China increased almost 30 times from 51 million US$ in 2001 to 1,431 million U.S$ in 2004[61].

Table 8: details of tariff cuts on China-US WTO agreement

Priority products	Tariff pre-agreement	Tariff post-agreement
Beef	45%	12%
Pork	20%	12%
Poultry	20%	10%
Citrus	40%	12%
Grapes	40%	13%
Apples	30%	10%
Almonds	30%	10%
Cheese	50%	12%
Ice-cream	45%	19%
Fish	>20%	10%
Wine	65%	20%

[59] Susan Hamrock and Corey Whiting, "China's energy into the WTO", Export American, Page 23-26, Jan 2002
[60] http://www.uschina.org/public/wto/wtobenefits.html
[61] TradeStats Express Home@ http://tse.export.gov/

Source: Whitehouse 1999 and USTR 1999

(ii) Industrial products

- ✧ Average tariffs (overall) were cut from 25% level in 1997 to 9.4% level overall and 7.1% level on U.S. priority products.
- ✧ China will eliminate all tariffs on Information Technology products, such as computers and appliance, telecommunications equipment, semiconductors, and other high technology products.
- ✧ China will reduce tariffs on automobiles from 100% level in 1999 to 25% level by 2006 and auto parts tariffs will be cut to 10% level on average by 2006
- ✧ Significant cuts will also be made in the wood and paper sectors, going from pre-agreement levels of 12-18% on wood and 15-25% on paper down to levels generally between 5% and 7.5%.
- ✧ There are some other product sectors where China has agreed to substantial tariff reductions, such as beer, furniture, toy, cosmetics, distilled spirits, medical equipment, scientific equipment and textiles.

(iii) Quotas and licenses

China has agreed to eliminate quotas and quantitative restrictions with phase-ins limited to five years.

- ✧ China will eliminate existing quotas upon accession for the top U.S. priorities (e.g. optic fiber cable). It will phase-out remaining quotas, generally by 2002, but no later than 2005.
- ✧ For import licenses: China's import licensing system can no longer function as a trade barrier and must comply with the principles of national treatment and nondiscrimination.

(iv) Import and distribution rights

Trading rights and distribution are the major concerns of China's WTO agreement by US manufacturing sector. Before the agreement, Chinese government restricted trading rights and distribution. Foreign owned enterprises have no trade rights or the right to distribute products other than those they make in China, or to own or manage distribution networks, wholesaling outlets or warehouses. Under the

Agreement, China will provide, for the first time, trading rights and distribution rights to U.S. firms. Trading rights will be progressively phased in over three years. Distribution rights will be provided even for China's most restricted distribution sectors such as wholesale, transportation, maintenance and repair.

(v) Services

China has agreed to eliminate market access restrictions in almost all service sectors especially in sectors important to the United States including banking, insurance, telecommunications and professional services (including accounting, legal and management consultancy services).

- ✧ China will **grandfather** all existing current market access and activities in all services sectors. This will protect existing American distribution services, financial services, and professional services providers in China.
- ✧ **Telecommunications**

  With this agreement, China will phase out all geographic restrictions for paging and value-added services in two years, mobile/cellular in five years and domestic wireline services in six years. China will allow 49 percent foreign investment in all telecommunication services, and will allow 50 per cent foreign ownership for value added in two years and paging services in three years. Through these commitments, China will become a member of the Basic Telecommunications Agreement.
- ✧ **For insurance**

  Under the agreement: China will permit foreign firms to insure large-scale risks nationwide immediately upon accession, and will eliminate all geographic limitation for future licenses over five years. China will expand the scope of activities for foreign insurers to include group, health and pension lines of insurance, which represent about 85 per cent of total premiums, phased in over five years.
- ✧ **Banking**

  China has committed to full market access in five years for USA banks. Foreign banks will be able to conduct local currency business with Chinese enterprises

starting two years after accession and be able to conduct local currency business with Chinese individuals from five years after accession. Foreign banks will have the same rights (national treatment) as Chinese banks within designated geographic areas.

Both geographic and customer restrictions will be removed in five years. Non-bank financial companies can offer auto financing upon accession.

✧ **Professional services**

China has agreed to provide, under the agreement, a broad range of commitments, including on legal, accountancy, taxation, management consultancy, architecture, engineering, urban planning, medical and dental, and computer and related services. China also will permit foreign majority control except for practicing Chinese law.

✧ **Travel and tourism**

Under the agreement, China will allow foreign travel operators to provide the full range of travel agency services. Foreign hotel operators will have full access towards the Chinese market. Majority ownership of hotels by foreign operators will be allowed on accession and full ownership will be allowed in 2004.

(vi) Technical barriers to trade

In accordance with the WTO Technical Barriers to Trade (TBT) Agreement, China cannot use technical regulations, standards and conformity assessment procedures as unnecessary obstacles to trade any longer. Instead, China will setup technical regulations based on international standards and these regulations must be developed in a transparent manner and applied equally to both domestic and foreign products

(vii) Taxes

China has agreed to ensure that its laws, regulations and other measures relating to internal taxes and charges levied on imports comply with WTO rules. This obligation will be applied in a nondiscriminatory manner, not only to national taxes but also to provincial and local taxes.

(viii) Subsidies

Under the agreement, China will eliminate, upon accession, all subsidies on industrial goods that are prohibited under WTO rules.

(ix) Textiles

China agreed that US keeps a safeguard, according to 1997 bilateral textiles agreement, which permits U.S. companies and workers to respond to increased imports of textile and apparel products. This textile safeguard will be removed on Dec. 31, 2008.

(x) Dumping

China has agreed that the US will maintain the current anti-dumping methodology (**treating China as a non-market economy**) in future anti-dumping cases and this provision will remain in force for 15 years after China's accession to the WTO.