

CRS Report for Congress

Received through the CRS Web

Agriculture: U.S.-China Trade Issues

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Summary

With China's entry into the World Trade Organization (WTO) in December 2001, U.S. agricultural interests were hopeful that longstanding barriers to trade with that vast and growing market would begin to fall. However, critics charge that China is failing to honor commitments to open its markets, affecting U.S. exports of grains, oilseeds, meat and poultry, and other products. U.S. agriculture and trade officials have been working to resolve these differences. This report will be updated if events warrant.

Introduction

Following years of negotiations, China was admitted to the World Trade Organization (WTO) in December 2001. U.S. proponents of Chinese accession foresaw China's further integration into the global economy and vast new market opportunities in the world's most populous country. U.S. agricultural exports to China, already an important destination, were projected to expand significantly as its government began to open its markets both to the outside world and to its own private sector.

While longer-term optimism prevails, U.S. and other exporters of agricultural products have encountered difficult near-term obstacles at the Chinese border. Some believe that at least a number of these obstacles may be contrary to commitments China has made in its agreements with the WTO and the United States. U.S. officials at all levels have been working with their Chinese counterparts to resolve these problems, without taking China into WTO dispute settlement.

U.S.-China Agricultural Trade

The stakes for U.S. agricultural producers are high. Although the United States has a large overall trade deficit with China, the value of its farm exports there far outpace farm imports (see table). From calendar year (CY) 1997 through CY2001, China has been the 7th largest foreign market for U.S. farm products; when Hong Kong is included, it is the 4th largest. The United States in recent years has provided about one-fourth of China's total agricultural imports and about one-third of all consumer food imports. With

a 1.2 billion population, rising incomes, and a growing middle class, China has enormous potential as a market for U.S. food and agricultural products.

| U.S. Agricultural Exports to China and Hong Kong, Million Dollars | | | | | |
|--|-------------|-------------|-------------|-------------|-------------|
| CY | 1997 | 1998 | 1999 | 2000 | 2001 |
| China | 1,604 | 1,340 | 854 | 1,716 | 1,939 |
| Hong Kong | 1,714 | 1,490 | 1,209 | 1,262 | 1,227 |
| Total | 3,318 | 2,830 | 2,063 | 2,978 | 3,166 |
| U.S. Agricultural Imports from China and Hong Kong, Million Dollars | | | | | |
| China | 681 | 741 | 766 | 812 | 816 |
| Hong Kong | 87 | 77 | 77 | 85 | 77 |
| Total | 768 | 818 | 843 | 897 | 893 |

Source: U.S. Department of Agriculture (USDA), Economic Research Service. *Foreign Agricultural Trade of the United States*.

Oilseeds and products (mainly soybeans) account for more than half the value of U.S. agricultural exports to China (excluding Hong Kong) since 1997. Animal products like hides and skins also have been significant U.S. exports, while vegetable products, meats, seafood, and grain exports have grown in recent years. Leading U.S. exports to Hong Kong are poultry and red meats and fruits and vegetable products.

According to USDA's Economic Research Service (ERS), China's WTO accession will increase international demand for major U.S.-produced commodities like wheat, corn, soybeans, and other products, raising U.S. farm prices by from 0.5% to 3% over a 2002-2009 baseline. U.S. exports, and net farm income, could increase by \$900 million and \$800 million, respectively, by 2009. However, those predictions hinge on a number of factors, not the least being the assumption that China will comply with its WTO commitments to open its markets (see below).

Recent Market Access Agreements

Chinese WTO Accession and Market Access Commitments. To gain WTO membership, China negotiated bilaterally with each of its major trading partners including the United States, and multilaterally with a WTO working party. The most favorable bilateral concessions were consolidated into a single WTO accession agreement. The U.S.-China bilateral agreement was signed in November 1999 and contained China's best offers on agricultural products. The bilateral market access commitments consolidated into the protocol of accession are available to all WTO members.

China agreed that with accession, it would gradually reduce, by 2004, its tariffs for agricultural products, from an average level of 22% to an average of 17%. The average reduction on several products important to the United States, including soybeans, meats, fruits, wine, and dairy products, are to be reduced from 31.5% to 14.5%. China also

agreed to establish tariff-rate quotas (TRQs) for bulk agricultural commodities, thereby meeting WTO requirements that non-tariff quantitative barriers be converted to TRQs. In a TRQ, specified levels of imports up to a quota limit can enter at low tariffs, with those above the limit assessed a much higher duty.

China also agreed not to use export subsidies on corn, cotton, and rice; to eliminate nontariff barriers by ensuring that inspection, testing, and other sanitary and phytosanitary (SPS) and technical measures comply with WTO rules; to cap and reduce trade-distorting domestic agricultural subsidies (to no more than 8.5% of national farm production value); and to make its trade and policy regulations public and more transparent.

In order for the United States to take advantage of these market concessions and to use the WTO dispute settlement mechanisms in any trade disputes, the United States had to grant China permanent normal trade relations (PNTR), which the 106th Congress approved and the President signed into law (P.L. 106-286). Passage of permanent NTR extends to China the same low tariffs applied to other WTO members. From 1980 to 2001, the United States essentially had been granting conditional NTR status, on a year-to-year basis. The PNTR debate pitted many U.S. commercial agricultural interests, who argued that PNTR would significantly raise U.S. farm exports, against others skeptical that China actually would open its markets and abide by WTO rules.¹ Such concerns now are at the heart of recent U.S.-China agricultural trade issues (see below).

1999 Agreement on U.S.-China Agricultural Cooperation. In the course of accession negotiations, China and the United States signed a bilateral agreement resolving several longstanding trade disputes regarding Chinese SPS restrictions on U.S. wheat, meat, and citrus imports. This agreement became effective immediately upon signature on April 10, 1999. Specifically, China agreed to: (1) eliminate restrictions on wheat imports from the Pacific Northwest that had been imposed out of concern that it had TCK smut, a plant fungus; (2) open its market to U.S. pork, beef, and poultry imports by promising to accept USDA certification of their safety; (3) eliminate its comprehensive ban on imports of U.S. oranges, grapefruit, and other citrus fruit. China did make some purchases of wheat, meats, and citrus, as it was working on its WTO accession, but U.S. exporters of these products say they have since encountered Chinese import barriers.

Selected Issues

Both the U.S. government and the WTO have established mechanisms to monitor China's implementation of its accession commitments, including those on agriculture. China's progress is affected by a number of factors. The country must contend with competing internal forces, including those likely to benefit from more open trade (e.g., those in the private sector), and others that stand to lose (e.g., displaced farmers and workers, Communist officials, provincial governments, etc.). Also, China must have time to rewrite rules to comply with WTO and other global standards, and to make them more consistent and transparent.

¹ PNTR opponents also raised other issues such as China's questionable human rights policies and labor standards, and U.S. national security concerns. For more details on the trade agreements discussed here, see CRS Report RS20169, *Agriculture and China's Accession to the World Trade Organization*.

China has sought to vigorously protect its agricultural sector (which accounted for 27.5% of its Gross Domestic Product in 2000) out of fears that import competition and other WTO-fueled changes will cause major economic pain and social instability. Nearly two-thirds of China's 1.3 billion people are rural, according to USDA. On the other hand, Chinese policies that shield its farmers from WTO reforms create sectoral inefficiencies and tie up resources that could generate investment and jobs in other economic sectors, Western economists have argued. Nonetheless, these Chinese internal tensions may help to explain some of the difficulties faced by U.S. negotiators seeking resolution of agricultural trade issues.² (Not all of these issues necessarily violate WTO rules, nor are U.S. officials pursuing WTO dispute settlement to resolve them at this time.)

Tariff-Rate Quotas. For example, one China WTO accession commitment was to set new TRQ quantities for wheat, corn, rice, cotton, and soybean oil (all important U.S. exports) with in-quota duties ranging from 1% to 9%. Non-government enterprises were to receive a specified share of each TRQ each year so that U.S. firms can deal directly with Chinese customers rather than through the tightly-controlled state trading enterprises (STEs). The commitment is for transparency in TRQ administration, and reallocation of unused STE quotas to other buyers in China who want to import products.

China repeatedly delayed announcement of regulations for the TRQs, and when announced, they did not appear to provide the market access that the United States and other exporting countries had anticipated under China's WTO agreement. U.S. officials complain that U.S. exporters have been unable to identify clearly which users in China have received TRQs, and how much. TRQs for wheat have been distributed in shares that are too small to be commercially viable. Chinese officials are requiring that some of the non-STE TRQ allocations be processed for re-export rather than used at home. This likely violates WTO rules, U.S. interests have reported. Also, China reportedly has newly imposed a value-added tax (VAT) of 13% on grain imports to further discourage imports. These and other grain-related problems (see below) may in part reflect Chinese efforts to reduce large domestic surpluses of wheat and corn, according to analysts.

Export Subsidies. Although China agreed to end grain export subsidies upon WTO accession, they continue, according to U.S. reports. Secretary of Agriculture Ann Veneman reported in late July that Chinese officials had acknowledged that they may be doing so in violation of their WTO commitments. U.S. companies and government authorities have reported that Chinese corn continues to receive export subsidies and that subsidies for wheat exports also have been instituted. For example, they contend, corn has been exported at prices that have been \$20 to \$30 per metric ton less than China's domestic price, and at prices below those of corn-producing competitor nations.³

² See the USDA Economic Research Service website on *China: WTO Accession, Implementation Issues* at [www.ers.usda.gov/briefing/china/wto-implementation.htm] for details and references.

³ Chinese corn exports are expected to remain strong through at least the 2002 marketing year, according to an October 10, 2002, report from USDA's agricultural attache in China (GAIN Report #CH2048). "Subsidies appear to be continuing despite China's WTO commitment, and China's grain stocks remain very large—giving the motivation for further exports," the report concludes, noting that corn imports are "negligible and wheat imports weak because of large domestic stocks and stronger world prices."

Biotechnology Regulations. U.S. farm and trade interests also express concern about permanent new Chinese rules (now in abeyance) for approval and labeling of farm products containing genetically modified organisms (GMOs). These rules were set to take effect in March 2002, but Chinese officials delayed them first until December 20, 2002, and again until September 20, 2003. Meanwhile, a temporary GMO import regime is in place whereby GMO products are supposed to be acceptable if exporting countries have approved them and they are undergoing Chinese testing and approval procedures. In the interim, however, U.S. producers worry that confusing, conflicting, and overly vague rules still could impede U.S. soybean exports to China – valued at \$1 billion annually in recent years – and other GMO products. Among specific U.S. complaints are: uncertainties about how the import regime will function; likely extensive new paperwork requirements; concerns that Chinese officials in the future will arbitrarily impose additional inspection and quarantine requirements; the expectation that several different agencies (e.g., the Ministry of Agriculture, and the Ministry of Health) will have to approve GMO imports, using separate and possibly conflicting sets of rules; and how to ensure that the transition from the interim system to a permanent one does not further disrupt trade.

Impediments to U.S. Meat and Poultry Imports. U.S. meat and poultry industry officials contend that China has not complied with its commitments, both in the WTO and under the 1999 Agreement on U.S.-China Agricultural Cooperation, to accelerate removal of all unjustifiable non-tariff measures restricting trade. China has imposed a more burdensome import permit system that “arbitrarily” restricts import quantities to 200 tons per import permit, according to U.S. industry officials. Also, the system only issues permits to beef and poultry product types that do not compete with domestically produced goods, they charge. Import permits take approximately 30 days to be issued compared with 48 hours prior to WTO accession, they add. Recently, China unilaterally de-listed several USDA-approved meat and poultry plants under a “zero tolerance” standard for pathogens, despite the absence of published regulations for imports including pathogen standards – violating both the 1999 Agreement and of the UR Agreement on the Application of SPS Measures, U.S. meat industry organizations wrote in a June 20, 2002, joint letter to the U.S. Trade Representative (USTR). Chinese officials in July denied that they were using these practices to restrict imports. China also said it would delay for 6 months (through March 31, 2003) what U.S. officials said were costly and burdensome new labeling requirements for imported beef, pork, and poultry, according to reports in *Inside U.S.-China Trade*.

Other Import Problems. U.S. wheat exporters have reported that China has continued to discourage imports of wheat from the Pacific Northwest, which it had previously blocked due to concerns about the presence of TCK smut. The imposition of additional handling requirements and other hurdles for Pacific Northwest wheat would be a violation of the 1999 Agreement, which lifted the earlier ban as long as any TCK spores are at or below the tolerance levels specified in the Agreement. China also has denied access to its markets for a number of other U.S. farm and food products on SPS grounds, including fresh potatoes, avocados, peaches, pears, and certain apple varieties, according to the USTR. On August 9, 2002, China notified the WTO of proposed new cotton quality standards for imports, to take effect next year, which U.S. government and industry officials assert are arbitrary and unreliable and thus would violate WTO rules. New Chinese restrictions for natural fertilizer imports also are at issue.

Outlook for Resolution

As noted, the United States has established mechanisms for monitoring China's performance in meeting its accession commitments. In addition, U.S. trade and agriculture officials have been working diligently, both through meetings and consultations with Chinese officials at all levels, and, in some cases, through the WTO, to resolve the various problems which have arisen. Up to now, however, U.S. officials have not invoked WTO dispute settlement procedures. Among other things, they want to ensure that long-term growth in agricultural trade with China will continue, and to allay skepticism among some U.S. farm groups about Chinese intentions.

For example, the United States in late June 2002 requested formal WTO consultations (invoked under the Uruguay Round Agreement on Agriculture, or URAA, not WTO dispute settlement procedures) on the grain TRQ and related issues. These issues also were among a number of the trade concerns raised by Agriculture Secretary Veneman during her trip to China in late July. Secretary Veneman said during her trip that she had appointed USDA Senior Trade Counsel David Hegwood to lead a working group on biotechnology with China. Meanwhile, other U.S. authorities were to continue meeting with the Chinese on the issue, and other high-level Administration trade officials were to travel to China to seek clarifications of the GMO rules.

After U.S. meat and poultry industry officials raised concerns about barriers to their exports to China, the United States formally complained to China. However, they acknowledged that substantiating such charges might prove difficult, given that Chinese importers were orally informing U.S. exporters of the questionable practices rather than providing any written documentation of them.

Chinese officials have countered with criticism of U.S. farm policy, and particularly the new farm bill signed in May 2002, which they contend is trade-distorting. They state that its passage could cause them to increase their own agricultural subsidies, and will make it more difficult for them to meet their WTO obligations.⁴

Past experience in resolving agricultural trade disputes – not only with China but with other U.S. trading partners – suggests that their satisfactory resolution usually takes extended time and effort and, often, the intervention of officials from the highest levels, even the countries' leaders. Some U.S. agricultural producers remain skeptical that China will act expeditiously to further open its markets to their exports. Nonetheless, given the size and growth potential of the Chinese market, the desire of the U.S. government and businesses to bring China into the global economic community, and the new ability to use the WTO dispute settlement mechanisms if necessary to pressure China to meet its obligations, other U.S. farm interests remain optimistic about their future prospects there.

⁴ For information on the bill including a pro-con analysis, see CRS Report RL31195, *The 2002 Farm Bill: Overview and Status*.