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# **Impact of China's Accession to the WTO and Policy Implications for Asia-Pacific Developing Economies**

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- \* This paper is the revised version of the paper entitled "Policy Implications for Asia-Pacific Countries of the Accession of China to the World Trade Organization," which was presented at the Asia-Pacific Regional Forum on Industrial Development in Shanghai, China on 4-5 December 2000.

## **Executive Summary**

This paper analyzes the economic impact of China's entry into the WTO on developing economies in the Asia-Pacific region (AP developing economies), and provides guidance for their national policies.

A landmark deal on U.S.-China trade promises to open up one of the world's largest economies to unprecedented foreign competition. China has committed to conduct a substantial reduction in tariffs and remove most quotas on both agricultural and industrial products. A more striking and surprising outcome from the deal is China's comprehensive commitments to phase out restrictions in a broad range of services over a relatively short period. Noting, however, that most of AP developing economies are expected to benefit little from China's liberalization in service sector, quantitative analyses in this paper are focused on the impact of China's tariff reduction on AP developing economies.

Analyses show that most East and Southeast Asian economies have great interest in exporting products such as industry special machines (SITC 72), office and data processing machines (SITC 75) and electrical equipment (SITC 77). It is therefore expected that significant tariff reduction on these products will provide great export opportunities for East and Southeast Asian economies. In particular, Korea and Chinese Taipei are to be the greatest beneficiaries of China's overall tariff reduction. On the contrary, China's import expansion of primary products in which some South and Southeast Asian economies have interests is quite limited. In that respect, China's liberalization schedule seems biased toward the import of capital intensive products and provides benefits to relatively advanced economies in the Asia-Pacific region.

The paper also shows by conducting constant market share analysis (CMS) that the phase-out of MFA by 2004 and China's accession to the WTO may pose a great challenge to AP developing economies. While it is difficult to predict exactly what will be the consequence of MFA abolition, small but protected textile and apparel suppliers of AP developing economies will be certainly exposed to additional competition from other currently restrained but competitive exporters like China.

The paper concludes with the following suggestions for AP developing economies, which are designed to help them compete better in the world market as well as in the Chinese market.

First, they have to accelerate trade and investment liberalization by active participation in multilateral trading system, regional economic cooperation and bilateral investment treaties. Second, they have to put efforts to follow international standards for new issues such as environment, labor, investment, competition policy and transparency in government procurement. Third, they have to restructure their domestic industries to strengthen competitiveness by fostering knowledge-based industries including the service industry. Finally, they have to secure the human resource capacity to quickly adjust to change of the world economy by expanding investment in education and by ensuring flexibility of labor market.

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# Contents

## . Introduction

## . China and AP Developing Economics in the World Economy

1. Recent Economic Performance
2. Structure of World Trade and AP Developing Economies

## . China's Liberalization Schedule

1. Basic Policy Directions
2. Overview of the U.S.-China Agreement
3. Assessment of Liberalization Schedule

## . Impact on AP Developing Economies

1. Areas of Export Interest for AP Developing Economies
2. Impact of Tariff Liberalization on Developing Economies' Exports
3. Competition between AP Developing Economies and China in Overseas Markets:  
Some Implications for Textile and Apparel Exports

## . Policy Implications

1. Trade and Investment Liberalization
2. Response to New Trade Issues
3. Industrial Restructuring
4. Human Resource Development

## Reference

## Tables

|            |                                                                            |
|------------|----------------------------------------------------------------------------|
| Table II-1 | Economic Indicators of World and AP Developing Economies (1999)            |
| Table II-2 | Forecast of 2005 Major Economic Indicators                                 |
| Table II-3 | Regional Structure of Trade by Commodity Group                             |
| Table II-4 | Commodity Structure of Trade by Region                                     |
| Table II-5 | Export Structure by Commodity Group of AP Developing Economies (1990-1997) |

|             |                                                       |
|-------------|-------------------------------------------------------|
| Table III-1 | Objectives for 2010                                   |
| Table III-2 | Schedule of Tariff Reduction on Agricultural Products |
| Table III-3 | Schedule of TRQs on Grains                            |
| Table III-4 | Schedule of Tariff Reduction on Industrial Products   |
| Table III-5 | Schedule of Tariff Reduction on Automobiles           |
| Table III-6 | Liberalization Schedule of Major Service Sectors      |

|             |                                                                                                    |
|-------------|----------------------------------------------------------------------------------------------------|
| Table IV-1  | Top 5 Suppliers in Major Markets (1998)                                                            |
| Table IV-2  | Market Shares of AP Economies in Major Markets                                                     |
| Table IV-3  | Market Shares of AP Economies in China and USA by Commodity                                        |
| Table IV-4  | RCA of AP Economies in China (1998)                                                                |
| Table IV-5  | Major Areas of Export Interest                                                                     |
| Table IV-6  | Trade-Weighted Tariff Reduction Schedule and Expected Import Expansion for Selected Product Groups |
| Table IV-7  | Export Opportunities for Individual Economies by Product                                           |
| Table IV-8  | Major Suppliers of Textile and Clothing to the U.S.                                                |
| Table IV-9  | MFA Quota Utilization Ratio of Asian Suppliers                                                     |
| Table IV-10 | Factors of Export Growth: MFA Category Total (U.S.)                                                |
| Table IV-11 | Factors of Export Growth : Total Apparel (U.S.)                                                    |

## Figures

Figure II-1 Growth of World Trade by Commodity Group (1995-1998)

Figure IV-1 China's Import Structure (1995-1998)

## **I. Introduction**

China successfully negotiated with the United States on December 15, 1999 and with the European Union on May 19, 2000 over the matter of its WTO accession. Although the approval processes by the WTO General Council and ratification by China's People's Congress remain, China's entry into the WTO is likely to be realized in 2001.

WTO accession will launch China into the global economy, accelerating its market opening process. The expectation is that this will bring tremendous changes to the international economy as well as China's domestic economy. While developed countries like the U.S., EU, Japan and Canada have been leading world trade order so far, it is expected that developing countries including China will become much more influential in the multilateral trading system if China joins the WTO. Thus, China will certainly fortify internationally its political and economic status.

First of all, China will be able to strive for an advanced economy with a new approach to the "reform and open door policy," which has been promoted since 1979. With entry into the WTO, China will be forced to remove barriers to trade and investment, improving market access to foreign capital and commodities. Consequently, China's market will expand, with the market function being activated, and foreign enterprises will increasingly advance in the Chinese market. During this process, some domestic industries may suffer from restructuring while the overall Chinese economy will become more competitive. Taking into account that China already enjoys MFN status with 140 trading partners, it may not be able to achieve a visible export increase for the time being. However, as the market expands in size and the market function works effectively, Chinese products will become more competitive internationally, in terms of price and non-price factors. Thus, Chinese products, which are of low price and good quality, will penetrate the world market. It is worth emphasizing, however, that such effects will take hold only if China complies with the WTO rules and bound commitments.



China's entry into the WTO will have a critical impact on the global economy as well. Primarily, as China promotes "reform and globalization," exports from other countries will rush into China. Then, competition among countries and firms to take a share of the huge Chinese market will create further trade, thereby contributing to the world economy. It is also conceivable that China will play an important role in strengthening the world trade order by reforming its domestic institutions in a way that is consistent with international norms.

However, China's entry into the WTO will dramatically alter the economic and trade structures of its trading partners, particularly the developing countries. In the short run, developing countries will be able to improve their trade balance with China, as it accelerates its market opening. In the long run, however, as Chinese products become more competitive in the world market, they are highly likely to make inroads in the markets of trading partners. In particular, developing economies in the Asia-Pacific region may be the most affected because their labor-intensive products will have to compete with Chinese commodities. Therefore, unless innovative reform is initiated by those countries, their export will fall behind the competition, and their economic growth will deteriorate.

This paper is designed to analyze the economic effects of China's entry to the WTO on developing countries in the Asia-Pacific region, and to offer guidance for their national policies. The paper consists of five chapters. Chapter II presents comparative analyses of general economic status and structures of trade and industries in developing countries in the Asia-Pacific region. Chapter III summarizes China's liberalization schedule on the basis of negotiations between China and the United States. Chapter IV investigates how China's entry to the WTO affects developing economies in the Asia-Pacific region. Chapter V finalizes the paper by providing policy implications for developing countries.

## **II. China and AP Developing Economies in the World Economy**

### **1. Recent Economic Performance**

Global economic conditions have improved after the Asian financial crisis of 1997. Economic growth remained strong in both advanced economies and Asian developing economies. Strong demand in the United States and other advanced economies contributed to the recovery of the Asian developing economies from recession. The Asian economies seem to be back on track and most macroeconomic variables look stable.

Asian developing economies recorded a significantly high economic growth until they were hit by the currency crisis in 1997. However, after a short period of serious economic and social turmoil, Thailand, the Republic of Korea, Indonesia, Malaysia and the Philippines - directly affected by the crisis - recovered by undertaking macroeconomic stabilization and structural reforms, which included unilateral liberalization of their trade and foreign investment regimes. Expansion of advanced economies' markets provided an external environment that was favorable for adjustment, with the United States playing a pivotal role with its ninth consecutive year of sustained strong output growth.

Despite Asia's high growth rate of 5.9%, which is significantly higher than that of all developing economies (3.8%), growth rates of individual countries varied considerably. Most East Asian economies grew at high rates. Korea and China were the most impressive, growing at 10.7% and 7.5%, respectively. Southeast Asian economies slowed a little in 1999, while South Asian countries recorded growth rates higher than the average growth rate for all developing economies. Having experienced serious political instability, Indonesia recorded a growth rate of 0.2%, which is, however, a turnaround after a severe contraction in 1998. The relatively strong performance of most Asian-Pacific (AP) developing economies is attributable to factors like export expansion, increased public

spending and strong domestic private demands, etc.

The external balance has remained sound and the balance of payment crisis seems to have receded, mainly thanks to the continued export growth, which is due to strong demand in North America. According to Table II-1, which summarizes the main economic indicators of 1999, external positions of AP economies seem to be comfortable. The current account position as a share of GDP is mostly positive except for some South Asian economies like Pakistan and India. Malaysian foreign exchange reserves continued to rise, reaching \$30.9 billion, mainly due to sustained current account surpluses. The situation is similar in Thailand whose gross official reserves are expected to be around \$ 30 billion thanks to a surplus in merchandise trade and tourism services.

**Table II-1. Economic Indicators of World and AP Developing Economies (1999)**

| Region            | GDP Growth | CPI  | Unemployment | Current Account | Trade(\$ bil) |        |
|-------------------|------------|------|--------------|-----------------|---------------|--------|
|                   |            |      |              |                 | Exp           | Imp    |
| <b>World</b>      | 3.4        | 3.6  | 6.3          | -0.6            | 6612.3        | 6620.9 |
| <b>Advanced</b>   | 3.2        | 1.4  |              | -1.1            | 3500.7        | 3564.9 |
| <b>Developing</b> | 3.8        | 6.6  |              |                 |               |        |
| <b>Asia</b>       | 5.9        | 2.4  |              | 2.3             | 2012.5        | 1816.1 |
| Bangladesh        | 5.2        | 6.2  |              |                 |               |        |
| India             | 4.5        | 4.7  |              | -1.9            | 53.7          | 72.8   |
| Pakistan          | 2.7        | 5.7  |              | -2.9            | 10.9          | 15.3   |
| Sri Lanka         | 4.3        | 4.7  |              |                 |               |        |
| Indonesia         | 0.3        | 20.8 | 19.1         | 3.5             | 57.8          | 44.8   |
| Malaysia          | 5.6        | 2.8  | 3.7          | 16.3            | 96.9          | 82.6   |
| Thailand          | 3.2        | 0.3  | 4.2          | 2.6             | 65.8          | 57.6   |
| Philippines       | 3.3        | 60.7 | 9.1          | 2.2             | 45.7          | 44.7   |
| Korea             | 10.7       | 0.8  | 6.3          | 6               | 169.4         | 145.3  |
| China             | 7.5        | 1.4  | 3.1          |                 | 219.7         | 208.3  |
| Singapore         | 5.4        | 0.5  | 4.6          | 24.8            | 155.3         | 141.6  |
| Chinese Taipei    | 5.8        | 0.5  | 3            | 3.3             | 144.8         | 135.5  |

Note: Growth and CPI data are from IMF and others are from DRI.

Source: IMF (2000), *World Economic Outlook*, DRI (2000), *World Outlook*.

Overall, the performance of macroeconomic variables including inflation looks stable, and provides a basis for optimism on the Asian economies. The IMF estimates that per capita incomes of East and Southeast Asian economies are expected to reach pre-crisis levels by the end of 2002. According to the long-term forecast made by the World Outlook, economic growth will continue to remain strong at least until 2005. The forecasted world GDP growth rate is 3.4%, which is significantly higher than that of 1999. The high growth forecast is associated with the high growth of developing economies. The average growth rate is expected to be 5.2%, while that of Asia remains at 3.9%. Among the AP developing economies, Korea and India are expected to slow down in their growth considerably from 9.1% and 6.3% in 1999 to 5.3% and 5.7% in 2005. However, international organizations like the IMF warn that due structural reforms should be undertaken in order to maintain the growth momentum of the AP developing economies.

**Table II-2. Forecast of 2005 Major Economic Indicators**

| Region            | GDP Growth | Per Capita | CPI | Unemployment | Current Account | Trade (\$ bil) |         |
|-------------------|------------|------------|-----|--------------|-----------------|----------------|---------|
|                   |            |            |     |              |                 | Exp            | Imp     |
| <b>World</b>      | 3.4        | 6824       | 3.4 |              | -1.0            | 1107.06        | 11307.6 |
| <b>Advanced</b>   | 2.8        |            | 2.4 |              | -1.2            | 5657.6         | 5829.6  |
| <b>Developing</b> | 5.2        |            | 7.2 |              |                 |                |         |
| <b>Asia</b>       | 3.9        | 3015       | 3.7 |              | 0.3             | 3261.5         | 3204.9  |
| Bangladesh        | 5.1        | 401        | 6.8 |              |                 |                |         |
| India             | 5.7        | 627        | 5.8 |              | -2.6            | 93.6           | 125.2   |
| Pakistan          | 5.0        | 595        | 5.5 |              | -4.2            | 17.7           | 24.8    |
| Sri Lanka         | 5.4        | 1214       | 6.8 |              |                 |                |         |
| Indonesia         | 6.0        | 1292       | 7.0 |              | -1.0            | 107.7          | 105.6   |
| Malaysia          | 5.5        | 5763       | 4.1 | 4.4          | 0.6             | 196.5          | 190.9   |
| Thailand          | 6.6        | 3919       | 4.7 |              | -5.0            | 87.6           | 100.8   |
| Philippines       | 4.7        | 1172       | 5.8 | 8.3          | -3.0            | 56.5           | 60.4    |
| Korea             | 5.3        | 12841      | 4.9 | 4.3          | -1.3            | 801.9          | 872.9   |
| China             | 8.1        | 1460       | 6.5 |              |                 | 507.9          | 591.3   |
| Singapore         | 5.9        | 40383      | 1.2 | 2.4          | 16.7            | 247.3          | 221.2   |
| Chinese Taipei    | 6.4        | 21583      | 3.2 | 2.9          | 2.2             | 273.1          | 262.2   |

Source: DRI , *World Economic Outlook*.

Though it seems unlikely to lead to more turmoil, very recent developments both in the world economic environment and inside some Asian economies cast some doubts on the future of these economies in spite of their macroeconomic performance in the past two years. They are confronting volatile foreign exchange and stock markets. Structural adjustment is being delayed, making international investors think twice before they make any decisions. Such difficulties are coupled with high oil prices. There is growing speculation that the United States' nine-year economic boom will end soon. Overall, Asian economies seem to be facing a totally different world economic environment from the one in the beginning of 2000. In order to avoid another serious recession, Asian economies may have to learn from the past.

## **2. Structure of World Trade and AP Developing Economies**

World trade has grown again since 1999 from the slowdown of 1998. Again, strong demand in North America and the recovery of the Asian economies were the main forces. According to the WTO, "the recovery in Asia was stronger than expected and led to double-digit real import growth in 1999." In many countries, a fiscal stimulus, replenishment of inventories and a rebound in the global demand for electronic goods sustained the economic growth. Particularly, the information technology sector and the automobile industry recorded strong global output growth. Within the information technology sector, the unit sales of personal computers rose by 22% to 114 million units, and the dollar value of the global sales of semiconductors expanded by 18% to a new record level of \$160 billion. One of the most dynamic branches of the global information technology industry in 1999 was mobile phones. It is estimated that worldwide sales of mobile phones reached 283 million units, an increase of two thirds over 1998 sales.<sup>1</sup> This observation leads us to examine the relevance of export structure of AP developing economies in the rapidly changing world trade structure. As exporting is the growth locomotive of most of the Asian developing economies, catching up with the global trend

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<sup>1</sup> *WTO Annual Report 2000.*

will be very important to maintain their new growth momentum.

Figure II-1 shows the structural change of world trade between 1995-1998 by commodity and region. Overall, Asian trade outgrew total world trade, trade by advanced economies and by all developing economies. The world trade in manufactures grew most significantly during this period. Trade in machinery and transportation equipment is unique, because it is the only sector in which trade by advanced economies recorded the highest growth among various groups of economies. The second highest growth by both advanced economies and the Asian economies was recorded in the sector of chemicals and chemical products. In all remaining products, the Asian economies are the most active traders. In short, world trade is becoming more dependent on Asian economies. In terms of commodity, trade shares of industrial and capital intensive products like machinery, transportation equipment, chemicals seem to be ever increasing. This feature of world trade development suggests that it may be more reasonable to explain international trade flows by theories based on technological aspects and economies of scale rather than by the factor endowment theory alone.

**Figure II-1. Growth of World Trade by Commodity Group(1995-1998)**

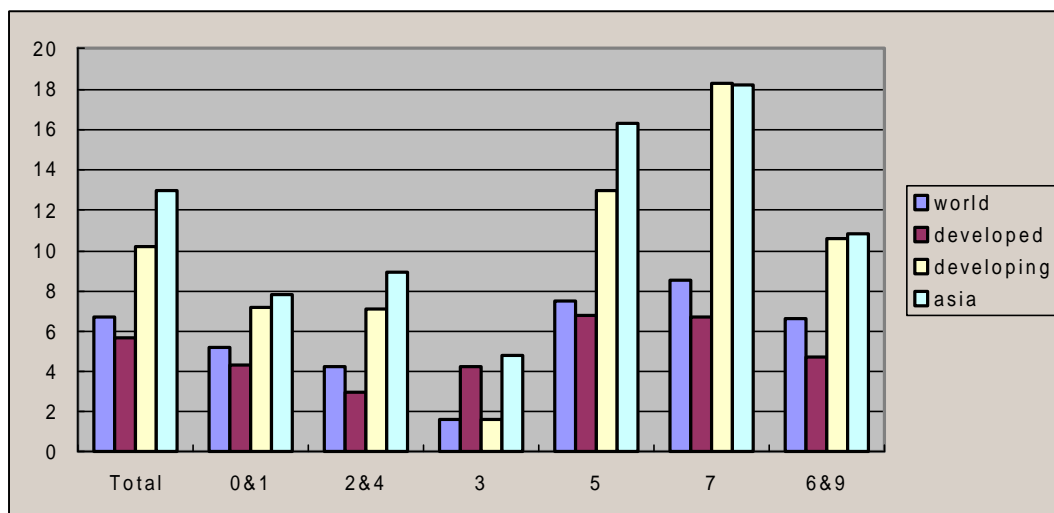


Table II-3 describes the regional structure of trade and changes thereof by commodity group during 1995-1998. The EU takes the largest portion of exports and imports in all categories. For example, shares of the EU's export and import of SITC 0&1 (food, live animals) are 41.7% and 42.4% respectively, mainly due to its heavy intraregional trade. However, the EU's shares have decreased for most exports and imports during 1995-1998. The United States is both a heavy exporter and importer of manufactured products. Unlike the EU, exports and imports of most categories increased their shares during the same period. The developing Asian economies increased their shares remarkably. Their shares of total exports and imports grew to 19.6% and 18.3%, respectively. Exports of the Asian developing economies are highly concentrated on other manufactured goods under SITC 8.

**Table II-3. Regional Structure of Trade by Commodity Group**

(%, share of own trade)

| SITC                               | Developed Economies |        | Developing Economies |        | EU     |        | US     |       | Japan  |        | Developing Asia |        |
|------------------------------------|---------------------|--------|----------------------|--------|--------|--------|--------|-------|--------|--------|-----------------|--------|
|                                    | Exp.                | Imp.   | Exp.                 | Imp.   | Exp.   | Imp.   | Exp.   | Imp.  | Exp.   | Imp.   | Exp.            | Imp.   |
| <b>0-9</b> Total                   | 66.8                | 64.9   | 29.4                 | 29.4   | 38.5   | 36.4   | 11.9   | 15.5  | 7.8    | 5.4    | 19.6            | 18.3   |
| All Commodities                    | (-4.5)              | (-5.5) | (6.0)                | (6.0)  | (-4.5) | (-6.1) | (1.0)  | (1.3) | (-0.6) | (-0.1) | (6.5)           | (5.5)  |
| <b>0&amp;1</b> Food, Live Animals, | 64.5                | 66.4   | 32.3                 | 26.0   | 41.7   | 42.4   | 11.3   | 9.1   | 0.5    | 9.7    | 13.6            | 12.2   |
| Beverages, Tobacco                 | (-4.0)              | (-4.9) | (3.9)                | (3.1)  | (-4.1) | (-5.7) | (-1.0) | (0.2) | (0.0)  | (0.5)  | (2.1)           | (3.3)  |
| <b>2&amp;4</b> Crude Materials,    | 58.4                | 60.9   | 35.1                 | 33.1   | 24.3   | 35.2   | 14.3   | 9.6   | 1.3    | 10.7   | 18.7            | 21.2   |
| Oils, Fats                         | (-4.8)              | (-7.4) | (6.2)                | (7.2)  | (-4.7) | (-6.5) | (-1.6) | (1.7) | (0.2)  | (-2.3) | (5.0)           | (5.6)  |
| <b>3</b> Mineral Fuels,            | 32.7                | 60.5   | 56.7                 | 20.3   | 14.4   | 30.6   | 2.9    | 18.4  | 0.5    | 7.6    | 12.2            | 11.2   |
| Lubricants                         | (5.2)               | (-1.0) | (0.0)                | (-3.9) | (0.4)  | (-1.3) | (-0.3) | (1.4) | (0.2)  | (-1.5) | (2.4)           | (-1.3) |
| <b>5</b> Chemicals                 | 79.8                | 63.7   | 16.6                 | 31.0   | 51.3   | 41.6   | 13.7   | 9.7   | 5.9    | 3.9    | 11.4            | 18.8   |
|                                    | (-3.7)              | (-4.8) | (4.8)                | (5.0)  | (-5.4) | (-6.6) | (0.9)  | (2.2) | (0.7)  | (-0.5) | (4.8)           | (4.4)  |
| <b>7</b> Machinery,                | 75.2                | 64.9   | 23.0                 | 31.5   | 40.2   | 34.2   | 15.1   | 18.4  | 13.6   | 3.7    | 19.4            | 20.2   |
| Transport Equipment                | (-9.3)              | (-7.1) | (10.5)               | (7.8)  | (-6.7) | (-7.6) | (0.8)  | (0.9) | (-3.2) | (0.8)  | (8.7)           | (7.0)  |
| <b>6&amp;8</b> Other               |                     |        |                      |        |        |        |        |       |        |        |                 |        |
| Manufactured Goods                 | 61.6                | 66.5   | 34.4                 | 28.8   | 39.6   | 37.7   | 8.6    | 15.4  | 5.3    | 5.5    | 26.8            | 18.5   |
|                                    | (-7.6)              | (-7.3) | (8.0)                | (6.9)  | (-8.4) | (-8.0) | (1.4)  | (1.3) | (-0.7) | (0.2)  | (6.4)           | (5.7)  |

Note: Numbers in ( ) indicate % point change during 1995-1998.

Source: UN International Trade Statistics (1999)

However, exports of machinery and transportation equipment recorded the highest increase while other export shares increased in all categories too. It is expected that rebounding oil prices have led to an increase of world fuel exports in excess of 20%, and above average growth was also recorded for office and telecom equipment, and automotive products.<sup>2</sup>

While it is true that developing economies have great stakes in manufactures trade, it is important to note that their shares fall very short of the average level of developed economies. Table II-4 shows the trade structures of major trading groups. Machinery and transport equipment (SITC 7) takes the lion's share of total world trade, followed by other manufactured goods of SITC 6&8. Developed economies' export share of machinery and transport equipment (44.4%) greatly exceeds the world average (39.5%), though the export share of other manufactured goods fall just short of the average. This pattern is most conspicuous in U.S. and Japanese trade. U.S. and Japanese export and import shares of machinery and transportation are even greater than the average of developed economies, while those of other manufactured goods are far lower. In contrast, developing Asian economies' imports of machinery and transportation equipment exceed their exports of these products. Meanwhile, Asian developing economies have increased their share of machinery exports by 10.5% points during 1995-1998, while export share of other manufactured products decreased by 5.7% points. Import shares of machinery and transportation equipment increased significantly and uniquely, implying again that developing economies need to enhance their export structures consistently with the structural change of world trade. They are moving in the right direction, but there still is a long way to go.

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<sup>2</sup> *WTO Annual Report (2000)*.



**Table II-4. Commodity Structure of Trade by Region**

(%, share of own trade)

| SITC                                                     | Developed      |               | Developing      |               | EU             |                | US            |                | Japan          |                | Developing Asia |               |
|----------------------------------------------------------|----------------|---------------|-----------------|---------------|----------------|----------------|---------------|----------------|----------------|----------------|-----------------|---------------|
|                                                          | Economies      |               | Economies       |               |                |                |               |                |                |                |                 |               |
|                                                          | Exp.           | Imp.          | Exp.            | Imp.          | Exp.           | Imp.           | Exp.          | Imp.           | Exp.           | Imp.           | Exp.            | Imp.          |
| <b>0-9</b> Total,<br>All Commodities                     | 100            | 100           | 100             | 100           | 100            | 100            | 100           | 100            | 100            | 100            | 100             | 100           |
| <b>0&amp;1</b> Food, Live Animals,<br>Beverages, Tobacco | 7.5<br>(-0.8)  | 8.0<br>(-0.7) | 8.6<br>(-1.8)   | 6.9<br>(-1.5) | 8.5<br>(-0.7)  | 9.1<br>(-0.7)  | 7.4<br>(-2.3) | 4.6<br>(-0.8)  | 0.5<br>(-0.1)  | 14.2<br>(-0.2) | 5.4<br>(-2.1)   | 5.2<br>(-0.8) |
| <b>2&amp;4</b> Crude Materials,<br>Oils, Fats            | 3.8<br>(-0.8)  | 4.1<br>(-0.9) | 5.2<br>(-1.2)   | 4.9<br>(-0.8) | 2.8<br>(-0.7)  | 4.2<br>(-0.9)  | 5.3<br>(-2.2) | 2.7<br>(-0.2)  | 0.7<br>(0.0)   | 8.7<br>(-3.5)  | 4.2<br>(-1.2)   | 5.1<br>(-1.2) |
| <b>3</b> Mineral Fuels,<br>Lubricants                    | 3.8<br>(-0.4)  | 7.3<br>(-2.3) | 15.0<br>(-11.6) | 5.4<br>(-5.9) | 2.9<br>(-0.7)  | 6.6<br>(-1.7)  | 1.9<br>(-1.4) | 9.3<br>(-3.8)  | 0.5<br>(0.1)   | 11.1<br>(-7.0) | 4.9<br>(-3.3)   | 4.8<br>(-5.9) |
| <b>5</b> Chemicals                                       | 11.1<br>(0.7)  | 9.2<br>(0.6)  | 5.3<br>(0.9)    | 9.8<br>(0.0)  | 12.4<br>(0.7)  | 10.7<br>(0.7)  | 10.8<br>(0.4) | 5.8<br>(1.1)   | 7.1<br>(1.6)   | 6.9<br>(0.0)   | 5.4<br>(1.0)    | 9.6<br>(-0.3) |
| <b>7</b> Machinery,<br>Transport Equipment               | 44.4<br>(2.7)  | 39.4<br>(3.4) | 30.9<br>(12.1)  | 42.3<br>(6.7) | 41.3<br>(2.9)  | 37.0<br>(2.4)  | 50.3<br>(4.2) | 46.8<br>(3.6)  | 69.1<br>(-1.6) | 27.6<br>(8.9)  | 39.0<br>(10.5)  | 43.6<br>(7.3) |
| <b>6&amp;8</b> Other Manufactured<br>Goods.              | 26.0<br>(-1.9) | 29.1<br>(-1)  | 33.2<br>(0.9)   | 27.8<br>(1.0) | 29.2<br>(-2.9) | 29.4<br>(-1.4) | 20.5<br>(1.6) | 28.2<br>(-0.1) | 19.3<br>(-1.2) | 29.2<br>(2.0)  | 38.8<br>(-5.7)  | 28.7<br>(0.2) |

Note: Numbers in ( ) indicate % point change during 1995-1998.

Source: UN International Trade Statistics (1999)

This observation contradicts the traditional view that liberalization of manufactures trade is in the interest of developed countries. In fact, manufactures exports account for almost three quarters of developing country exports. Some projections show that the share of manufactures share will increase to 80% in 2000. Such a change in the structure of merchandise exports has potentially important implications for the AP developing economies with China's accession to the WTO. Not only do the average developing economies gain from liberalization of the Chinese market, but also as a group including China they would have a greater stake in the next round of multilateral trade negotiations for liberalization of these products.

Of course, export structures of AP developing economies are not homogeneous. The differences in export structure will lead to different impacts on their exports to the Chinese

market. Table II-5 summarizes export shares and changes thereof during 1990-1997. First, South AP economies are relatively dependent on primary exports. The exports of primary products (SITC 0) reached 16.8% and 19.8% for India and Sri Lanka, respectively. These figures are significantly higher than those for other AP economies except Thailand (18.0%). In particular, the share of primary exports in India increased by 2.9% points during this period, while share increases of major manufactured goods (SITC, 6, 7, 8) remained at around 1% point. Shares of exports of light industry products including leather, rubber and machines, etc. and miscellaneous manufactured articles including apparel, footwear, etc. are 39.0% and 19.0% respectively, while those for Sri Lanka are 15.5% and 53.1%.

**Table II-5. Export Structure by Commodity Group of AP Developing Economies (1990-1997)**

| (%)            |      |       |      |       |      |      |      |       |      |      |      |       |      |      |      |      |      |       |      |       |
|----------------|------|-------|------|-------|------|------|------|-------|------|------|------|-------|------|------|------|------|------|-------|------|-------|
| Exports        | 0    |       | 1    |       | 2    |      | 3    |       | 4    |      | 5    |       | 6    |      | 7    |      | 8    |       | 9    |       |
|                | 1997 | Δ     | 1997 | Δ     | 1997 | Δ    | 1997 | Δ     | 1997 | Δ    | 1997 | Δ     | 1997 | Δ    | 1997 | Δ    | 1997 | Δ     | 1997 | Δ     |
| Bangladesh     | -    | -     | -    | -     | -    | -    | -    | -     | -    | -    | -    | -     | -    | -    | -    | -    | -    | -     | -    | -     |
| India          | 16.8 | 2.9   | 0.46 | -0.4  | 4.9  | -4.9 | 1.7  | -1.3  | 0.8  | 0.55 | 8.1  | 0.7   | 39.1 | 1.8  | 7.48 | 0.06 | 19.1 | 0.8   | 1.6  | -0.4  |
| Pakistan       | -    | -     | -    | -     | -    | -    | -    | -     | -    | -    | -    | -     | -    | -    | -    | -    | -    | -     | -    | -     |
| Sri Lanka      | 19.8 | -12.9 | 1.23 | 0.9   | 4.2  | -3.5 | 0.7  | -0.8  | 0    | -0.4 | 0.87 | -0.15 | 15.5 | 2.1  | 2.56 | -0.3 | 53.2 | 17.2  | 1.9  | -2.3  |
| Indonesia      | 7.56 | -1.3  | 0.46 | -0.1  | 10.2 | 3.5  | 25.8 | -17.9 | 3.2  | 1.52 | 3.46 | 1.14  | 21.8 | -2.1 | 10.0 | 8.7  | 17.4 | 6.96  | 0.2  | -0.3  |
| Malaysia       | -    | -     | -    | -     | -    | -    | -    | -     | -    | -    | -    | -     | -    | -    | -    | -    | -    | -     | -    | -     |
| Thailand       | 18.0 | -10.1 | 0.36 | -0.03 | 4.5  | -1.2 | 2.2  | 1.3   | 0.1  | 0.09 | 3.71 | 2.29  | 15.5 | -2.9 | 39.2 | 16.9 | 13.4 | -8.1  | 2.98 | 1.8   |
| Philippines    | -    | -     | -    | -     | -    | -    | -    | -     | -    | -    | -    | -     | -    | -    | -    | -    | -    | -     | -    | -     |
| Korea          | 1.95 | -1.1  | 0.14 | -0.05 | 1.3  | -0.2 | 3.9  | 2.9   | 0.03 | 0.03 | 7.83 | 3.97  | 21.4 | -0.7 | 50.0 | 10.7 | 8.84 | -19.7 | 4.59 | 4.3   |
| China          | 6.05 | -4.5  | 0.57 | 0.02  | 2.3  | -3.4 | 3.8  | -4.6  | 0.35 | 0.09 | 5.6  | -0.4  | 18.8 | -1.4 | 23.9 | 14.9 | 38.6 | 18.1  | 0    | -18.7 |
| Singapore      | 1.73 | -1.1  | 1.49 | 0.03  | 1.0  | -2.1 | 8.7  | -9.4  | 0.27 | -0.5 | 6    | -0.27 | 5.6  | -1.4 | 65.9 | 15.8 | 7.7  | -1.2  | 1.5  | 0.2   |
| Chinese Taipei | -    | -     | -    | -     | -    | -    | -    | -     | -    | -    | -    | -     | -    | -    | -    | -    | -    | -     | -    | -     |

Note: Numbers in the right columns of each economy (Δ) indicates % point change during 1990-1997.

Southeast Asian economies share a similar export structure. Although exports of manufactured goods are most important, primary exports also have a significant share. However, the export structures of Southeast Asian economies are in the process of rapid

change. In Thailand, the share of primary exports decreased by more than 10% points during the last decade, while that of machineries and transportation equipment (SITC 7) increased by almost 17% points. Indonesian exports of these products increased by 8.7% points, though the contraction of primary export is relatively small. In the Philippines, merchandise exports and their contribution to GDP increased significantly. Also, the export structure continued to shift from primary to manufactured products, the share of which reached 86% in 1997. Major exports include electronics, automotive products and apparel.

Finally, the export structure of Asian middle income economies is quite different from other AP developing economies. For instance, Korea's exports are concentrated on machinery and transportation equipment (SITC 7), with the total share of manufacture exports over 90%. During 1997-1990, the share of heavy industry grew 10.7% points while that of light industrial products shrank considerably.

## **. China's Liberalization Schedule**

### **1. Basic Policy Directions**

China has achieved 10% annual economic growth and is considering the first ten years of the 21<sup>st</sup> century as a strategic period for heading towards an advanced economy. Since China promulgated the first explicit industrial policy in 1989, its economic policies have been oriented toward industrial restructuring. While striving to strengthen the status of agriculture by developing the rural economy, it has promoted the development of so-called 'pillar' industries such as those of machinery, electronics, petroleum and raw chemicals, automobiles, and construction. Such industrial restructuring has also proceeded in relation to foreign trade. The foreign trade policy has been made to encourage exports of agricultural products, home electronic appliances, and some high value-added products. Encouragement was also granted to imports of crucial parts, equipment and technologies.

With such a trade policy, China's trade volume has substantially grown to make it the ninth largest trading nation in the world. Furthermore, as China successfully transforms its economy from a centrally planned autarchy into a market-based system, it has become fairly open to trade and investment. Since the early 1990s, China has gradually cut its tariff rate from over 40% to the current 17%. As for non-tariff barriers, after the landmark promulgation of the "Law of Foreign Trade of the People's Republic of China" in 1994, China accelerated the elimination of license requirements and most import quotas and introduced an automatic import licensing system.<sup>3</sup>

In its bid for membership in the WTO, China has made comprehensive commitments to liberalize trade and investment. Therefore, with China's entry into the WTO, many of the trade barriers are expected to be further lowered or removed and foreign enterprises in China will have a better chance to gain "national treatment".

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<sup>3</sup> Lu, Ding, 'Industrial Policy and China's Participation in Globalization', China-Korea Economic Forum (2000), p. 9.

**Table III-1 Objectives for 2010**

- |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"><li>▪ GDP to double 2000 figure.</li><li>▪ Control population within 1.4 billion and enable people to lead an “even more comfortable life.”</li><li>▪ Establish “a relatively complete socialist market economy,” a sounder macroeconomic control system with better agility and effectiveness, and a regulatory framework more in compliance with the rule of law.</li><li>▪ Establish a modern enterprise system for state-owned enterprises and develop a number of internationally competitive large enterprises and business groups.</li><li>▪ Optimize industrial structure by:<ul style="list-style-type: none"><li>- Enhancing commercialization and specialization in agriculture;</li><li>- Building up a group of national infrastructure projects and matching development of infrastructure and basic industries to national economic growth;</li><li>- Promoting pillar industries and making them the major driving force of economic growth;</li><li>- Increasing markedly the proportion of the tertiary sector in the national economy and its service function.</li></ul></li><li>▪ Promote a more coordinated development of regional economies and gradually narrow the gap in development between different regions.</li></ul> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

Source: Lu (2000), p. 6.

The “Five-year Plan for National Economic and Social Development and the Long-term Target for the Year 2010” defines new directions of state intervention and provides a blueprint for national development into the 21st century (Table III-1).<sup>4</sup> According to the outlines, economic reform and industrial restructuring must be China’s main policy instruments to ensure sustainable and rapid economic growth in the globalized economy. In specific, institutional building for a market economy and development of the “pillar industries” will be the major policy agenda in coming years. Furthermore, it is expected that China will accelerate the plan upon its entry to the WTO in response to the comprehensive market openings. Accordingly, China will shift from the centrally planned economy to the socialist market economy where the market plays a fundamental role in resource allocation, and from an quantitative growth mode to an qualitative growth mode driven by increasing efficiency and productivity.

<sup>4</sup> Those outlines were approved at the 4<sup>th</sup> session of China’s 8<sup>th</sup> National Peoples’ Congress in March 1996.

## **2. Overview of the U.S.-China Agreement**

### **Agriculture and Fisheries**

By joining the WTO, China is committing to establish a “tariff-only” import regime. Any other measures such as inspection, testing or domestic taxes must be applied in a manner that is consistent with WTO rules requiring a transparent and non-discriminatory system and all health measures must be based on sound science. The tariff on agricultural products will decline from an overall average of 22% to 17.5%<sup>5</sup> (Table III-2), and that on fishery products will be reduced from 25.3% to 10.6% by January 1, 2005. For grains, tariff rates on sorghum will be reduced from 3% to 2%, and those on barley malt will be reduced from 30% to 10% by 2004. Tariff concessions on key dairy products that China will phase in by 2004 are as follows: cheese from 50% to 12%, yogurt from 50% to 10%, lactose from 35% to 10%, ice cream from 45% to 19%, and other food preparations from 25% to 10%. For key meat products, tariff concessions by 2004 are as follows: frozen beef cuts from 45% to 12%, frozen beef tongue and offal as well as frozen pork cut and offal from 20% to 12%, and frozen chicken and turkey parts from 20% to 10%. Furthermore, tariffs on specialty crops such as vegetables, nuts and citrus will be reduced from 13-30% to 10-15%, 30-35% to 10-20%, and 35-40% to 12-15%, respectively.

As for tariff-rate quotas (TRQ), China, like many WTO members, will use a TRQ system (Table III-3) and state trading for certain sensitive commodities such as wheat, corn, rice, cotton and soybean oil. China will permit any entity, including foreign enterprises, to have the right to import and distribute most agricultural and fishery products, which is to be phased in over a three-year period. China has also committed not to grant export subsidies for agricultural products when it joins the WTO, while agreeing to cap and reduce trade-distorting domestic subsidies.

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<sup>5</sup> The average duty on agricultural products of U.S. priority interest will fall from 31% to 14%.

**Table III-2 Schedule of Tariff Reduction on Agricultural Products**

| Items           |                                  | Current Rate (%) | Reduced Rate (%) | Due Year     |
|-----------------|----------------------------------|------------------|------------------|--------------|
| <b>Averages</b> |                                  | 22               | 17.5             | Jan. 1, 2005 |
| Grains          | Sorghum                          | 3                | 2                | 2004         |
|                 | Barley Malt                      | 30               | 20               |              |
| Dairy           | Cheese                           | 50               | 12               | 2004         |
|                 | Yogurt                           | 50               | 10               |              |
|                 | Lactose                          | 35               | 10               |              |
|                 | Ice Cream                        | 45               | 19               |              |
|                 | Other Food Preparations          | 25               | 10               |              |
| Meats           | Frozen Beef Cuts                 | 45               | 12               | 2004         |
|                 | Frozen Beef Tongue & Offal       | 20               | 12               |              |
|                 | Frozen Pork Cuts & Offal         | 20               | 12               |              |
|                 | Frozen Chicken & Turkey Parts    | 20               | 10               |              |
| Vegetables      | Lettuce                          | 16               | 10               | 2004         |
|                 | Cauliflower                      | 13               | 10               |              |
|                 | Broccoli                         | 13               | 10               |              |
|                 | Canned Tomato Paste              | 25               | 20               |              |
|                 | Tomato Ketchup                   | 30               | 15               |              |
| Nuts            | Shelled Almonds and Hazelnuts    | 30               | 10               | 204          |
|                 | Pistachios                       | 35               | 10               |              |
|                 | Shelled & Canned                 | 30               | 20               |              |
|                 | Walnuts                          |                  |                  |              |
| Citrus          | Oranges, Lemons, Grapefruits     | 40               | 12               | 2004         |
|                 | Grapefruit Juice                 | 35               | 15               |              |
| Other Fruits    | Apples, Pears, Cherries, Peaches | 30               | 10               | 2004         |
|                 | Plums, Raisins                   | 40               | 10               |              |
|                 | Grapes                           | 40               | 13               |              |
|                 | Wine                             | 65               | 20               |              |
|                 | Other Fruits and Nuts            | 30               | 20               |              |
|                 | Grape Juice                      | 35               | 20               |              |
|                 | Water-based Drinks with Sugar    | 65               | 20               |              |
|                 |                                  |                  |                  |              |
| Other Products  | Ginseng                          | 40               | 10               | 2004         |
|                 | Cigarettes                       | 65               | 25               |              |

Source: USTR (1999)

Table III-3 Schedule of TRQs on Grains

(Unit: metric ton)

| Items |                 | Initial TRQ | 2004 TRQ  | Private Share     | 1998 Total Imports |
|-------|-----------------|-------------|-----------|-------------------|--------------------|
| Wheat |                 | 7,300,000   | 9,636,000 | 10%               | 2,000,000          |
| Corn  |                 | 4,500,000   | 7,200,000 | 25%, grows to 40% | 250,000            |
| Rice  | Total           | 2,660,000   | 5,320,000 |                   | 250,000            |
|       | Short/Med Grain | 1,330,000   | 2,660,000 | 50%               |                    |
|       | Long Grain      | 1,330,000   | 2,660,000 | 10%               |                    |

Source: USTR (1999)

### Industrial Products

China has made a comprehensive commitment to reduce tariff or non-tariff barriers in the industrial sector. The average tariff rates are to be reduced to 9.4% with some major items to be lowered to 7.1% (Table III-4), and the quotas in general will be eliminated by 2002 or at least by 2005. The most remarkable changes were seen in the areas of automobiles and information and technology products. According to the agreement, China will lower the tariff rates of automobiles from 80-100% to 25% by 2006 after WTO accession (Table III-5), cutting those of related major components from 23.4% to 10%, and eliminate the import quota system by 2005. In particular, quotas on autos will be phased out by 2005 at a rate of 15% annually until eliminated. China also agreed to sign the Information Technology Agreement (ITA) on accession, thereby committing to eliminate tariffs on all products covered by the ITA by January 1, 2005.

Other items with which mostly developed countries are concerned such as aircraft, equipment and pharmaceuticals will also go through substantial tariff reductions. For civil aircraft, tariffs on all items in Annex 1 of the Agreement on Trade in Civil Aircraft will be bound and reduced from the current average rate of 14.7% to a final average rate of 8% after China's accession, with most restrictions completed by January 1, 2002. In particular, quotas and licenses will be eliminated upon accession for all items in the Agreement on Trade in Civil Aircraft. Tariffs on construction, medical and scientific equipment are to be reduced from 13.6% to 6.4% by January 1, 2004, from 9.9% to 4.7% by January 1, 2003, and from 12.3% to 6.5% by January 1, 2003, respectively. China will reduce its average tariff on pharmaceuticals by 60% from its current average tariff of 9.6% to 4.2% by January



1, 2003.

**Table III-4. Schedule of Tariff Reduction on Industrial Products**

| Items                           | Current Rates (%) | Reduced Rate (%) | Due Year       |
|---------------------------------|-------------------|------------------|----------------|
| <b>Averages</b>                 | 17                | 9.4              | 2005           |
| Automobiles                     | 80-100            | 25               | 2006           |
| Auto Parts                      | 23.4              | 10               | 2005           |
| Information Technology Products | 13                | 0                | Jan. 1, 2005   |
| Civil Aircraft                  | 14.7              | 8                | Jan. 1, 2002   |
| Construction Equipment          | 13.6              | 6.4              | Jan. 1, 2004   |
| Medical Equipment               | 9.9               | 4.7              | Jan. 1, 2003   |
| Scientific Equipment            | 12.3              | 6.5              | Jan. 1, 2003   |
| Pharmaceuticals                 | 9.6               | 4.2              | Jan. 1, 2003   |
| Chemicals                       | 14.74             | 6.9              | Jan. 1, 2005   |
| Fertilizers                     | 6                 | 4                | Upon accession |
| Cosmetics                       | 45                | 10 or 15         | 2004 or 2005   |
| Textiles & Apparel              | 25.4              | 11.7             | Jan. 1, 2005   |
| Steel & Steel Products          | 10.3              | 6.1              | Jan. 1, 2003   |
| Furniture                       | 22                | 0                | Jan. 1, 2005   |
| Lumber                          | 15-25             | 12-18            | Jan. 1, 2005   |
| Paper & Paper Products          | 14.2              | 5.5              | Jan. 1, 2005   |

Source: USTR (1999)

**Table III-5 Schedule of Tariff Reduction on Automobiles**

| Rate | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 1/2006 | 7/2006 |
|------|------|------|------|------|------|------|--------|--------|
| 100% | 77.5 | 61.7 | 50.7 | 43.0 | 37.6 | 30.0 | 28.0   | 25.0   |
| 80%  | 63.5 | 51.9 | 43.8 | 38.2 | 34.2 | 30.0 | 28.0   | 25.0   |

Source: USTR (1999)

Tariffs on the products such as chemicals, furniture, paper, steel and textiles may be of concern to developing countries in general but to somewhat varying degrees. According to the agreement, China will reduce tariffs on chemicals by more than 50% by January 1, 2005, with the average rate of 14.74% being reduced to a final average rate of 6.9%. In specific, China will reduce its tariffs on fertilizers and cosmetics, from 6% to 4% upon accession, and from around 45% to 10% or 15% by 2004 or 2005, respectively. Tariff reductions on chemicals cover more than two-thirds of the products in the Tariff Harmonization Agreement of the Uruguay Round. Probably, products of the greatest concern to developing countries may be textiles and apparel, which also will go through a substantial tariff reduction. The average tariff on those items will be reduced from 25.4% to

11.7%, which will commence upon accession and be completed by January 1, 2005. Most quotas on priority U.S. exports will be eliminated upon accession, except those on thirty yarn, synthetic filament tow and fiber products, which will be eliminated after one year. Tariffs on steel and steel products, another important item to some developing countries, will be reduced from 10.3% to 6.1% by January 1, 2003. A striking tariff reduction is to be made on furniture items, too. China has committed to reduce its current average tariff rate of 22% to 0% on all furniture items covered by the Uruguay Round sectoral initiative. Reduction will commence upon accession and will be fully implemented by January 1, 2005. While tariffs on lumber will be lowered from 15-25% to 12-18%, those on paper and paper products will be reduced from 14.2% to 5.5% by January 1, 2005.

## **Services**

China's accession to the WTO will certainly contribute to the removal of various restrictions in service sectors. In the agreement with the United States, for example, China has made commitments to phase out most restrictions on a broad range of service sectors, including telecommunications, distribution, banking and insurance, professional services such as accountancy and legal consulting, and audiovisual services, etc (Table III-6).

For telecommunication services, the Chinese government has decided to lift the geographical limitation on beepers and value-added services within 2 years and on PCS within 6 years following its accession to the WTO. Foreign service suppliers will be allowed to hold a 30% foreign equity share upon accession, 49% after 1 year, 50% after 2 years in the area of value-added services. Foreign service suppliers will be also able to provide all analog / digital cellular services and PCS, and they will be allowed to hold a 25% foreign equity share one year after accession, 35% after 3 years, and 49% after 5 years. While there is no specific commitment or relevant domestic rules regarding portal-site management and content providers, the Chinese government has been publicizing a plan to open those markets in the form of joint ventures.

**Table III-6 Liberalization Schedule of Major Service Sectors**

| Sectors                                  | Foreign Equity Shares                                                                                                | Geographical Limitations                     |
|------------------------------------------|----------------------------------------------------------------------------------------------------------------------|----------------------------------------------|
| <b>Telecommunications</b>                |                                                                                                                      |                                              |
| Value-added Service                      | 30% upon accession, 49% after 1 year, 50% after 2 years (of accession)                                               | No restrictions after 2 years (of accession) |
| Mobile Voice and Data Services           | 25% after 1 year, 35% after 2 year, 49% after 5 years                                                                | No restrictions after 5 years                |
| Domestic and International Services      | 25% after 3 years, 35% after 5 years, 49% after 6 years                                                              | No restrictions after 6 years                |
| <b>Distribution</b>                      |                                                                                                                      |                                              |
| Wholesale and Commission Agents Services | Joint ventures within 1 year, foreign majority equity share within 2 years, wholly owned subsidiaries within 3 years | No restrictions within 2 years               |
| Retails                                  | No restrictions within 3 years                                                                                       | No restrictions within 3 years               |
| Franchising                              | No restrictions within 3 years                                                                                       | No restriction within 3 years                |
| <b>Banking</b>                           | Licensed with certain thresholds and choose legal form after 5 years                                                 |                                              |
| <b>Insurance</b>                         |                                                                                                                      |                                              |
| Non-Life Insurance                       | Branch 51% upon accession, wholly owned subsidiary within 2 years                                                    | No restrictions within 3 years               |
| Life Insurance                           | 50% upon accession                                                                                                   | No restrictions within 3 years               |

Source: USTR (1999)

China also agreed to phase out restrictions for all products in distribution services within 3 years. Foreign service suppliers will be permitted to establish joint ventures within one year of accession, and foreign majority equity shares will be allowed with all geographical and quantitative restrictions eliminated within two years after accession.<sup>6</sup> Even in retailing services, within 3 years from the date of accession, there will be no restrictions on equity, geographic areas or the number of service suppliers.

According to the agreement, China will gradually expand the scope and geographic opportunities for foreign banks to conduct local currency business. For example, local currency business with foreign clients will be permitted upon accession, with Chinese enterprises 2 years and with Chinese individuals 5 years after accession. For geographic restrictions, local currency banking will be permitted in four cities upon accession, four additional cities will be permitted each year thereafter, and nationwide access 5 years after

<sup>6</sup> Within three years after accession, foreign service suppliers may establish wholly owned subsidiaries.

accession. However, foreign currency business will be allowed without geographic restrictions on accession. On the other hand, China will phase out all geographic restrictions on the insurance market within 3 years of accession. In particular, joint ventures with partner of choice at 50% equity share will be permitted upon accession for life insurance. While foreign service suppliers of non-life insurance will be permitted to establish branches and joint-ventures at 51% equity share upon accession, wholly owned subsidiaries will be permitted within a year from the date of accession.

China has agreed on market access and national treatment for accounting, auditing and bookkeeping services. Foreign accounting firms will be permitted to affiliate with Chinese firms and enter into contractual agreements with their affiliated firms in other WTO member countries. These firms must be represented by certified public accountants (CPA) licensed by Chinese authorities; however, existing accounting firms are exempt from this requirement. CPA licenses will be issued on a national treatment basis where applicants will be informed of results in writing no later than 30 days after submission of their application. For legal services, foreign firms will be able to provide services in the form of a profit-making representative office, giving advice on international conventions and practices, and the law of other WTO members in which the lawyer is licensed to practice. While they are not allowed to employ Chinese nationals as lawyers for the practice of Chinese law, it can enter into long-term “entrustment” contracts providing for close working relationship with firms practicing Chinese law.<sup>7</sup> All geographic and quantitative restrictions will be phased out within 1 year of China’s accession, which means that foreign firms can open more than one office anywhere in China.

An agreement was also made to open the Chinese audiovisual market. Foreign service suppliers will be permitted to establish joint ventures which will distribute audiovisual

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<sup>7</sup> The chief representative of a foreign law firm must be a partner or equivalent in a law firm from a WTO member country. All representatives must be a member of the bar in a WTO member country, possess three years experience outside of China, and reside in China no less than six months each year.

content with equity share up to 49%. Furthermore, 40 movies will be imported upon accession, while 50 movies will be imported within 3 years.

### **Others**

China's commitments to eliminate non-tariff measures and certain conditions on exports and investment all enter into effect immediately upon accession to the WTO. According to these commitments, China will eliminate the requirements for foreign-exchange balance, local contents and export performance to implement the WTO Agreement on Trade-Related Investment Measures (TRIMs). China has also agreed that the government will not condition its approval of an investment based on whether a company provides offsets, transfers technology, uses locally produced goods, or conducts research and development in China.

In addition, China has confirmed the application of WTO rules to state-owned enterprises and extended those disciplines to state-invested enterprises where the government has an equity interest. Under these commitments, China's state-owned and state-invested enterprises are required to buy and sell based on commercial considerations, such as quality and price.

### **3. Assessment of Liberalization Schedule**

A landmark deal on U.S.-China trade promises to open up one of the world's largest economies to unprecedented foreign competition. First of all, China has committed to conduct a substantial reduction in tariffs and remove most quotas on both agricultures and industrial products. Many sectors previously considered off-limits, including banking and telecommunications, will be forced to prepare for competition from bigger and stronger foreign companies in two to five years.

While China maintained high tariff rates of 40% or higher in the early 1990s, they were

substantially reduced to an average rate of 16.8% by 1999. The tariff rates will be further reduced to 10% by 2005 according to the agreement. Some researchers have estimated that such tariff cuts will bring about an additional increase in China's imports by about \$18-20 billion in 2005.<sup>8</sup> So China's trade volume is expected to reach more than \$600 billion in that year, which is almost twice the level in 1998. Furthermore, as China will establish a "tariff-only" import regime by eliminating quotas on most products, the price mechanism will work effectively through the market in which consumers benefit from a wider choice of products at cheaper prices.

A more striking and surprising outcome from the deal is China's comprehensive commitments to phase out restrictions in a broad range of services over a relatively short period. It is striking because currently foreign service business in China is strictly limited. For example, China currently not only limits foreign banks to foreign currency business in selected cities and to foreign customers only, but also permits foreign securities firms to trade only a limited number of stocks. Similarly, China allows selected insurance companies to operate in China on a limited basis in only two cities. Furthermore, foreign service suppliers are prohibited from providing telecom services in China, and companies are generally prohibited from distributing imported products or providing related distribution services such as repair and maintenance services. Such restrictions on the service sector will start to be removed right after accession to the WTO, being phased out over the 5 year period in general.

While these liberalization measures, removing or relaxing tariff and non-tariff barriers, will certainly benefit almost all trading partners of the world, it is highly likely that developed countries, in particular the United States, will gain the most benefits. This is because the commitments were made to favor products or services of U.S. priority interest. For example, the average tariff rates on agricultural products of U.S. priority interest are to be reduced from 31% to 14%, compared to the overall average rates declining from 22% to 17.5%.

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<sup>8</sup> Yoo (1999), Rosen (1999).

Furthermore, China will be required to eliminate export subsidies and provide increased import quotas on wheat, corn, rice and cotton for the United States. Similarly, while the average tariff rates on overall products are to be reduced from 17% to 9.4%, the major products in which the United States has the priority interest will fall to 7.1%. Automobiles, aircraft, medical or scientific equipment, and pharmaceuticals are typical examples. China's liberalization schedule will certainly favor the United States even in relation to the service sector because China committed to mostly open up the service sectors in which the United States has comparative advantage. As a result, it is expected that U.S. banks, insurance companies, telecommunication firms and film exporters will rush to China after its accession to the WTO in order to occupy its huge market. However, other developed countries will also gain from China's market-opening because they have, in general, similar industrial structure to the United States.

It is also worth mentioning that even developing countries will obtain benefits directly or indirectly from such liberalization. As the United States and other developed countries accelerate their exports of value-added products to China, demand for raw materials will surge, from which developing countries can expand exports of raw materials or related intermediate goods. It is quite plausible that the price of those materials or intermediate goods may rise as the issue of environmental protection or preservation of natural resources becomes their priority concerns. This will also provide developing countries with favorable terms of trade in international markets. Such effects are expected mainly for products such as textiles, steel, lumber, paper and furniture. They can also expand exports of some agricultural products, in particular specialty crops, to China.

However, China's liberalization of service sectors may not directly affect developing economies, at least in the short run. The only possibility is that they can induce more foreign direct investment from developed countries who are willing to take advantage of cheaper rents or labor costs as well as geographical condition. The industrial structure of South Asian economies supports this view. The shares of primary products in total value

added are 32%, 25%, 22% and 18% for Bangladesh, India, Pakistan and Sri Lanka, respectively. On the other hand, the shares of the financial sector, one of the major areas of service trade, and transportation and communication are less than 10% total. Since exports by South Asian countries are centered mostly on some primary and manufactured products, the benefits from China's liberalization would be greatest in the related areas. For example, more than a half of exports by Pakistan are cotton-based exports. The situation is more or less similar in other South Asian countries: exports of some manufactures take a dominant share, being particularly concentrated on several light industrial products.

While the situation is quite different in some countries of other Asian regions such as Singapore, Chinese Taipei and Korea, it is expected that China's liberalization in service sectors will have minimal impact on most developing economies when the competitiveness of their service industries is considered.

There is another challenge against AP developing economies in general. China's accession to the WTO ensures that the MFA quota imposed annually will be abolished by 2004. Though it is not clear who will be the winner in the freer trading environments for textile and clothing, major exporters of these products in this region will be exposed to fiercer competition with China. While MFA quota is already in the process of being eliminated, it is still too early to assess the effects because no meaningful liberalization has yet been made. Presumably, the elimination of the MFA quota would divide the developing countries into higher cost and lower cost suppliers. For instance, Korea, Chinese Taipei and Hong Kong will be the most negatively affected because they currently have fairly sufficient quotas for exports and relatively high wage rates. It is also possible that the new and small suppliers will be squeezed out with the abolition of protection provided by the MFA quota. This argument is based on the productivity difference between large quota holders and small suppliers.<sup>9</sup>

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<sup>9</sup> Whalley (1995).



In these respects, our focus in the following chapter will be on somewhat detailed analyses of the impact of China's accession to the WTO on AP developing economies. First, we will see which areas or commodities are of major export interest for AP developing economies. For that purpose, the shares in major world export markets and comparative advantages of AP countries will be analyzed. Secondly, we will analyze the details of how tariff liberalization affects exports of AP developing economies to the Chinese market. The analyses will be based on the U.S.-China bilateral agreement. Thirdly, we will consider the issue of trade in textile and clothing because the MFA quota elimination will be one of the most immediate and foreseeable impacts on the exports of AP developing economies in coming years.

## IV. Impact on AP Developing economies

### 1. Areas of Export Interest for AP Developing Economies

China's import market is dominated by few suppliers such as Japan, the U.S., Chinese Taipei and Korea. The import share of these economies is over 60% of total imports. Compared to import structures of other major markets where the share of the top 5 suppliers is around 50%, this is a striking feature. It is most attributable to significantly high shares of Japan, Korea and Chinese Taipei, which are the geographically nearest economies to China, implying that explanation based on the gravity model of trade flows may be more relevant than the traditional resource-based international trade theory.

**Table IV-1. Top 5 Suppliers in Major Markets (1998)**

| Market         | Top 5 Suppliers(shares in Chinese market) |                   |                            |                    |                      |
|----------------|-------------------------------------------|-------------------|----------------------------|--------------------|----------------------|
| United States  | Canada<br>(18.41%)                        | Japan<br>(13.44%) | Mexico<br>(10.15%)         | China<br>(8.17%)   | Germany<br>(5.39%)   |
| European Union | U.S.<br>(17.56%)                          | Japan<br>(10.31%) | China<br>(6.99%)           | Germany<br>(5.42%) | Canada<br>(5.30%)    |
| Japan          | U.S.<br>(23.99%)                          | China<br>(13.35%) | Australia<br>(4.68%)       | Korea<br>(4.30%)   | Indonesia<br>(3.90%) |
| China          | Japan<br>(20.16%)                         | U.S.<br>(12.03%)  | Chinese Taipei<br>(11.85%) | Korea<br>(10.7%)   | Germany<br>(5.0%)    |

Source: UNCTAD TRAINS 2000

Performances of AP economies in the Chinese market are greatly different from each other. While India takes 13.9% of the EU market and 0.94% of the U.S. market, it takes only 0.64% in the Chinese market. Except for Pakistan, Thailand and Indonesia, South and Southeast AP economies in general have significantly higher shares in major export

markets than in the Chinese market. In contrast, Korea and Chinese Taipei show dramatically different bilateral trade flows with China from those of other AP developing economies. Korea's import share of the Chinese market is 10.7% while it is less than 3% of the U.S. market, and Chinese Taipei's share reaches almost 12% while its share in the U.S. remains at the level of 3.7%. This pattern of bilateral trade flow between AP developing economies and China shed some light on the possible effects of China's liberalization policy.

**Table IV-2. Market Shares of AP Economies in Major Markets**

|       | Bangladesh | India | Pakistan | Indonesia | Malaysia | Philippines | Thailand | Chinese Taipei | Korea |
|-------|------------|-------|----------|-----------|----------|-------------|----------|----------------|-------|
| U.S.  | 0.21       | 0.94  | 0.20     | 1.09      | 2.12     | 1.32        | 1.52     | 3.70           | 2.68  |
| EU    | 1.39       | 1.39  | 0.34     | 1.27      | 1.62     | 0.63        | 1.33     | 2.65           | 2.17  |
| Japan | 0.04       | 0.79  | 0.11     | 3.90      | 3.04     | 1.56        | 2.83     | 3.53           | 4.30  |
| China | 0.02       | 0.64  | 0.28     | 1.75      | 1.90     | 0.37        | 1.72     | 11.85          | 10.7  |

Source: Same as Table IV-1

Small suppliers of South Asian economies may expect greater opportunities in the Chinese market. Exports by these economies competing with Chinese domestic suppliers in the Chinese market will have better price competitiveness after China's tariff cuts. In our discussion in chapter II, we noted that the world economy is fast concentrating on high value-added and capital intensive products. As seen in Figure IV-1, the Chinese import structure seems to follow global trends. Therefore, in order for AP developing economies to benefit from such trend, they may have to realign their industrial and export structures to follow the changes in world trade structure in the longer term. In order to examine to what extent China's accession to the WTO will create export opportunities for AP developing economies, we may have to consider its liberalization plan with regard to product-specific performances of these economies in China.

**Figure IV-1. China's Import Structure (1995-1998)**

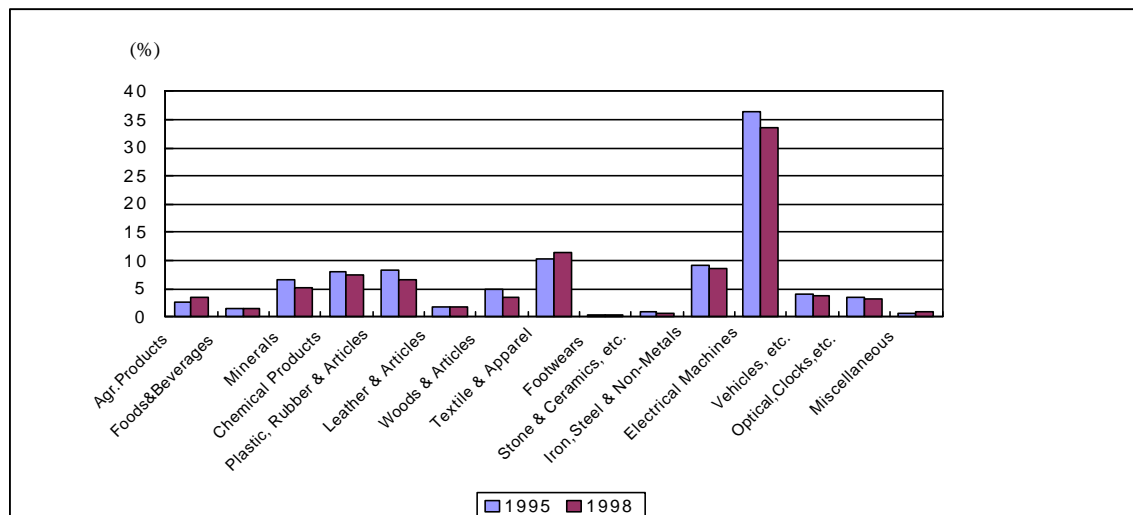


Table IV-3 shows that groups of AP developing economies have different stakes in the Chinese market compared to the U.S market. South Asian economies have limited market shares in China for manufactures (SITC 6-8), while they have meaningful shares in the U.S. For example, while India's market shares of manufactures in the U.S. are 3.24% and 21.59% for SITC 6 (manufactured goods classified as material) and 8 (miscellaneous manufactured articles) respectively, its shares in China are insignificant. Even in the category of SITC 7 (machinery and transportation equipment), India's relatively limited share in the U.S. is six times larger than that in China. On the other hand, India's share of primary products in China is about four times larger than that in the U.S.. This implies that these countries would gain much benefit from liberalization of primary products. Manufacture may be another area of interest for India considering the significant increase of its shares in both markets recently.

Export structures of Southeast Asian economies show an interesting pattern. That is, Indonesia, Thailand and Malaysia have higher market shares in China for many products. For instance, Malaysia has higher shares of machinery and other manufactured goods in the U.S. market, while the market shares of all other products are lower than those in China.

**Table IV-3. Market Shares of AP Economies in China and USA by Commodity**

| <b>China</b>   | <b>0</b> | <b>1</b> | <b>2</b> | <b>3</b> | <b>4</b> | <b>5</b> | <b>6</b> | <b>7</b> | <b>8</b> | <b>9</b> |
|----------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| Bangladesh     | 0.17     | -        | 0.13     | -        | -        | -        | 0.03     | -        | 0.03     | -        |
|                | 0.14     | -        | 0.04     | -        | -        | -0.07    | -0.04    | 0.00     | 0.01     | -        |
| India          | 6.50     | 0.01     | 2.99     | 0.05     | 2.18     | 0.24     | 0.71     | 0.02     | 0.19     | 0.02     |
|                | 6.04     | 0.01     | 1.25     | -0.13    | 1.08     | -0.02    | 0.42     | -0.01    | 0.13     | 0.02     |
| Pakistan       | 0.22     | -        | 0.15     | 0.04     | -        | 0.00     | 1.16     | 0.00     | 0.00     | -        |
|                | 0.01     | -        | -0.04    | -0.14    | -        | 0.00     | 0.54     | 0.00     | 0.00     | -        |
| Indonesia      | 2.35     | 0.05     | 4.20     | 6.83     | 8.41     | 1.16     | 3.14     | 0.18     | 0.18     | -        |
|                | 1.02     | 0.05     | 2.07     | -7.99    | 5.74     | -0.47    | 1.38     | 0.12     | 0.04     | -        |
| Malaysia       | 0.69     | 0.29     | 2.71     | 1.85     | 32.81    | 1.27     | 1.77     | 1.55     | 0.47     | 0.01     |
|                | 0.03     | 0.06     | 0.36     | -0.09    | 4.81     | 0.23     | 0.60     | 1.01     | 0.33     | -0.01    |
| Thailand       | 5.89     | 0.82     | 2.71     | 0.87     | 0.07     | 2.51     | 1.08     | 1.66     | 0.53     | 0.01     |
|                | -6.13    | 0.39     | -0.13    | 0.72     | -0.06    | 1.48     | 0.33     | 1.66     | 0.29     | 0.01     |
| Philippines    | 1.89     | 0.03     | 0.19     | 0.67     | 2.19     | 0.13     | 0.30     | 0.38     | 0.11     | -        |
|                | 1.35     | -0.08    | -0.22    | -1.56    | 1.80     | -0.27    | 0.16     | 0.34     | 0.05     | -        |
| Singapore      | 0.28     | 1.82     | 0.19     | 13.82    | 0.63     | 2.93     | 0.52     | 3.96     | 2.23     | 8.22     |
|                | 0.00     | 1.62     | -0.27    | -9.98    | -1.30    | 0.90     | -0.09    | 1.32     | 1.24     | -4.99    |
| Korea          | 1.96     | 0.63     | 4.88     | 16.01    | 0.29     | 18.36    | 18.28    | 5.77     | 7.60     | 0.49     |
|                | 0.88     | 0.51     | -0.16    | 8.31     | 0.26     | 4.78     | 4.94     | 1.33     | 1.17     | 0.49     |
| Chinese Taipei | 0.68     | 0.67     | 4.64     | 0.60     | 0.28     | 16.22    | 19.96    | 9.95     | 10.57    | 0.48     |
|                | -0.01    | 0.09     | -0.16    | -0.11    | 0.03     | -0.21    | -2.42    | -0.77    | -4.09    | -5.84    |

| <b>United States</b> | <b>0</b> | <b>1</b> | <b>2</b> | <b>3</b> | <b>4</b> | <b>5</b> | <b>6</b> | <b>7</b> | <b>8</b> | <b>9</b> |
|----------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| Bangladesh           | 0.26     | 0.01     | 0.01     | -        | -        | 0.00     | 0.08     | 0.00     | 1.02     | -        |
|                      | 0.03     | 0.01     | 0.00     | -        | -        | -0.03    | -0.01    | 0.00     | 0.11     | -        |
| India                | 1.77     | 0.20     | 1.49     | 0.00     | 2.63     | 0.84     | 3.24     | 0.12     | 1.59     | 0.00     |
|                      | 0.25     | 0.04     | 0.57     | -0.07    | 0.21     | 0.19     | 0.37     | 0.03     | 0.05     | 0.00     |
| Pakistan             | 0.09     | 0.00     | 0.05     | -        | -        | 0.00     | 0.69     | 0.00     | 0.53     | -        |
|                      | 0.01     | 0.00     | -0.03    | -        | -        | 0.00     | 0.19     | 0.00     | -0.05    | -        |
| Indonesia            | 2.85     | 0.40     | 3.36     | 0.79     | 4.71     | 0.23     | 1.19     | 0.49     | 2.22     | 0.00     |
|                      | 0.86     | 0.10     | -1.55    | -0.37    | 1.54     | 0.10     | 0.15     | 0.13     | -0.18    | -0.01    |
| Malaysia             | 0.32     | 0.03     | 0.97     | 0.38     | 12.88    | 0.46     | 0.48     | 3.46     | 1.55     | 0.27     |
|                      | 0.00     | -0.02    | -0.42    | 0.25     | 1.76     | -0.11    | -0.03    | -0.43    | -0.28    | 0.06     |
| Thailand             | 5.39     | 0.55     | 1.41     | 0.76     | 0.06     | 0.16     | 1.02     | 1.48     | 4.08     | 0.00     |
|                      | -0.74    | 0.02     | -0.57    | 0.74     | -0.01    | 0.02     | 0.01     | 0.08     | -1.84    | 0.00     |
| Philippines          | 1.38     | 0.10     | 0.16     | 0.00     | 19.07    | 0.06     | 0.25     | 1.80     | 1.77     | 0.01     |
|                      | -0.02    | 0.00     | -0.02    | 0.00     | -2.90    | -0.03    | 0.01     | 0.84     | -0.38    | -0.01    |
| Singapore            | 0.36     | 0.02     | 0.11     | 0.31     | 0.44     | 0.67     | 0.12     | 3.66     | 0.66     | -        |
|                      | -0.06    | 0.00     | 0.01     | 0.09     | 0.44     | -0.65    | 0.01     | -0.88    | -0.25    | -0.32    |
| China                | 2.24     | 0.48     | 2.59     | 0.71     | 0.53     | 2.82     | 6.37     | 5.19     | 23.85    | 0.13     |
|                      | -0.02    | 0.04     | 0.79     | -0.07    | 0.35     | 0.58     | 1.48     | 1.70     | 1.94     | 0.07     |
| Korea                | 0.39     | 0.24     | 0.88     | 0.35     | 0.07     | 1.35     | 3.15     | 3.53     | 2.37     | 0.14     |
|                      | -0.16    | -0.04    | 0.13     | 0.07     | -0.01    | 0.23     | 0.61     | -1.18    | -1.00    | 0.12     |
| Chinese Taipei       | 0.98     | 0.23     | 0.60     | 0.76     | 0.24     | 0.87     | 3.80     | 4.90     | 4.08     | 0.01     |
|                      | -0.05    | -0.01    | 0.05     | 0.74     | 0.00     | -0.14    | -0.44    | 0.08     | -1.84    | -0.13    |

Table IV-4 reports the competitiveness of exports as measured by revealed comparative advantage (RCA) in 1998 at SITC 1-digit level and summarizes the above discussions regarding AP developing economies' interests in the Chinese market. As an RCA in the Table represents export performance of a product relative to the overall exports of an individual AP developing country to China, products with a value higher than 1 can be said to "reveal" comparative advantage in the Chinese market. Overall, Southeast and South Asian economies have a similar group of products in which they reveal comparative advantage. Common areas in which they have RCA higher than unity includes: food and animals (SITC 0), crude materials (SITC 2) and animal and vegetable oils (SITC 4). The main difference between these two country groups is that Indonesia and Philippines reveal comparative advantage in mineral fuel while South Asian countries show strong competitiveness in manufactured goods. However, the difference deserves more scrutiny because this product group includes a wide variety of industrial products from textiles and apparel to iron and steel. We will come back to this point later on. For Korea and Chinese Taipei, products of RCA higher than 1 are limited to SITC 5 and 6, while RCAs of SITC 7 and 8 are far below 1. Comparing to their export shares of SITC 7 and 8 in the U.S. market, they do not seem to fully exploit their export potential in the Chinese market.

**Table IV-4. RCA of AP Economies in China (1998)**

| SITC        | 0           | 1    | 2           | 3           | 4            | 5           | 6           | 7           | 8           | 9    |
|-------------|-------------|------|-------------|-------------|--------------|-------------|-------------|-------------|-------------|------|
| Bangladesh  | <b>8.50</b> | 0.0  | <b>6.5</b>  | 0.0         | 0.0          | 0.0         | <b>1.50</b> | 0.0         | <b>1.50</b> | 0.0  |
| India       | <b>10.1</b> | 0.02 | <b>4.67</b> | 0.08        | <b>3.41</b>  | 0.38        | <b>1.11</b> | 0.03        | 0.30        | 0.03 |
| Pakistan    | 0.79        | 0.0  | 0.54        | 0.14        | 0.0          | 0.0         | <b>4.14</b> | 0.0         | 0.0         | 0.0  |
| Indonesia   | <b>1.34</b> | 0.03 | <b>2.40</b> | <b>3.90</b> | <b>4.81</b>  | 0.66        | <b>1.79</b> | 0.1         | 0.10        | 0.0  |
| Malaysia    | 0.36        | 0.15 | <b>1.43</b> | 0.97        | <b>17.27</b> | 0.67        | 0.93        | 0.82        | 0.25        | 0.01 |
| Philippines | <b>5.11</b> | 0.08 | 0.51        | <b>1.81</b> | <b>5.92</b>  | 0.35        | 0.81        | <b>1.03</b> | 0.30        | 0.0  |
| Thailand    | <b>3.42</b> | 0.48 | <b>1.58</b> | 0.51        | 0.04         | <b>1.46</b> | 0.63        | 0.97        | 0.31        | 0.01 |
| Korea       | 0.18        | 0.06 | 0.46        | <b>1.50</b> | 0.03         | <b>1.72</b> | <b>1.71</b> | 0.54        | 0.71        | 0.05 |
| C. Taipei   | 0.06        | 0.06 | 0.39        | 0.05        | 0.02         | <b>1.37</b> | <b>1.68</b> | 0.84        | 0.89        | 0.04 |

RCAs reported in Table IV-4 conceal real export interests because SITC 1-digit level data contain various products, some of which each economy may not export at all. Also, economies may have a great interest in some products even though they reveal a relatively lower level of comparative advantage in China if their export performance of those products is relatively good in other major markets. In order to evaluate the effects of China's accession to the WTO, it might be useful to list up products for which economies have RCA higher than unity or they have a relatively high level of exports. For example, while RCAs of Korean exports for SITC 7 and 8 are considerably low in China, it is clear that those are Korea's major exports in general. In this context, we identify products of SITC at 2-digit level for which AP economies might have interest in the Chinese market. The products and associated economies are presented in Table IV-5. These products may have RCA greater than 1 or their export shares may be relatively large. Numbers in the first column denote SITC 1-digit level of classification and those in the first row indicate second digits associated with the first digit numbers.

Several patterns appear in this table. First, South Asian economies appear to have comparative advantage in primary products and light industrial products like leather products and textile (SITC 61, 65). Also, Bangladesh recorded some exports of apparel (SITC 84), while India exported a limited amount of industrial machines. Second, Southeast Asian economies' major exports include rubber, cork and wood, pulp, and various kinds of machinery. Particularly, Malaysia and Thailand recorded a significant amount of industrial equipment and data processing machines. As far as Indonesia and Philippines are concerned, petroleum and products thereof, natural gas and vegetable oil are important areas of exports to the Chinese market. Third, exports from Korea and Chinese Taipei to China mostly consist of industrial products ranging from SITC 61 through SITC 85. Also, petroleum products and manufactured natural gas are important export products for Korea.

**Table IV-5. Major Areas of Export Interest**

|   | -1                                               | -2                                                                 | -3                                                        | -4                                                        | -5                                                        | -6                                         | -7                                                                 | -8             |
|---|--------------------------------------------------|--------------------------------------------------------------------|-----------------------------------------------------------|-----------------------------------------------------------|-----------------------------------------------------------|--------------------------------------------|--------------------------------------------------------------------|----------------|
| 0 |                                                  |                                                                    | Bang.<br>India                                            | Thai.                                                     | Philip.<br>Thai.                                          | Thai.                                      |                                                                    | India          |
| 1 |                                                  |                                                                    |                                                           |                                                           |                                                           |                                            |                                                                    |                |
| 2 |                                                  |                                                                    | Indo.<br>Malay.<br>Thai.                                  | Indo.<br>Malay.<br>Thai.                                  | Indo.<br>Thai.                                            | Bang.<br>India<br>Indo.<br>Malay.<br>Thai. | India                                                              | India<br>Thai. |
| 3 |                                                  |                                                                    | Indo.<br>Philip.<br>Sing.<br>Korea<br>C. Taipei           | Indo.<br>Philip.<br>Sing.<br>Korea<br>C. Taipei           |                                                           |                                            |                                                                    |                |
| 4 |                                                  | India<br>Indo.<br>Malay.<br>Philip.                                |                                                           |                                                           |                                                           |                                            |                                                                    |                |
| 5 | Korea<br>C. Taipei                               |                                                                    | Korea<br>C. Taipei                                        |                                                           |                                                           |                                            | Korea<br>C. Taipei                                                 |                |
| 6 | Bang.<br>India<br>Korea<br>Pakistan<br>C. Taipei |                                                                    | India<br>Indo.                                            | Indo.<br>Korea<br>C. Taipei                               | Bang.<br>India<br>Pakistan<br>Indo.<br>Korea<br>C. Taipei | India                                      | Korea<br>C. Taipei                                                 |                |
| 7 |                                                  | India<br>Malay.<br>Indo.<br>Thai.<br>Philip.<br>Korea<br>C. Taipei | Malay.<br>Thai.<br>Philip.<br>Korea<br>Sing.<br>C. Taipei | Malay.<br>Thai.<br>Philip.<br>Korea<br>Sing.<br>C. Taipei | Malay.<br>Thai.<br>Philip.<br>Korea<br>C. Taipei          |                                            | Malay.<br>Indo.<br>Thai.<br>Philip.<br>Korea<br>Sing.<br>C. Taipei |                |
| 8 | Indo.<br>Malay.<br>Thai.<br>Korea<br>C. Taipei   |                                                                    |                                                           | Bang.                                                     | Indo.<br>Thai.<br>Korea<br>C. Taipei                      |                                            |                                                                    |                |

Note: Each row represents SITC 1-digit classification and each column represents SITC 2-digit classification.

## 2. Impact of Tariff Liberalization on AP Developing Economies' Exports

There are many technical difficulties in evaluating China's tariff liberalization in detail. For instance, since the U.S.-China agreement for tariff reduction is based on HS 8-digit level of data, it is almost impossible to evaluate the tariff reduction schedule of all individual



products. Also, as we are evaluating the areas of export interest at SITC 2-digit level, we have to measure representative tariff rates for each category by controlling tariff rates for affected HS items. Therefore, we focus on products of export interest for AP developing economies at SITC 2-digit level. We compiled trade-weighted MFN average tariffs and included products of HS 6-digit level for which import values ranked in the top 10.

Table IV-6 illustrates China's tariff liberalization schedules and its impact on imports for selected products in which AP developing economies seem to have interest. Both current and bound tariff rates are weighted averages. Products undergoing the most significant tariff reductions include: machinery and electrical machinery (SITC 72, 74, 75, 77, 78), agricultural products (SITC 03), textile fibers (SITC 26) and other products of light industry such as wood manufactures, paperboard, textile yarn and fabric, iron and steel (SITC 63,64, 65, 67), and miscellaneous manufactured articles like building fixtures, apparel and footwear (SITC 81, 84, 85). Some items are missing in the China-U.S. agreements such as SITC 04, 05, 06,08 and 23 in which AP developing economies have some export interest. However, as the list of products of interest to AP developing economies includes most of the above items, China's liberalization schedule seems to be in conformity with the export interests of AP developing economies.

The expected expansion of imports is measured by applying implicit long-term price elasticity to the base year (1998) import values of individual products.<sup>10</sup> Significant increases in imports are expected for industry special machines (SITC 72), office and data processing machines (SITC 75) and electrical equipment (SITC 77). Most East and Southeast Asian economies have great interest in exporting. Except for Thailand and Indonesia, all economies have higher market shares of SITC 7 in the U.S. market than in the Chinese market. Although RCA for these products is less than 1 currently, significant

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<sup>10</sup> Elasticities for each product are calculated through dividing changes of import value by changes in trade-weighted tariffs between 1995-1998. We divided the elasticities by 2 to remove income effects on the import expansion during this period. So the effects from the tariff reduction are subject to relative importance of price and income effects on imports.

tariff reduction on these products would provide good opportunities for East and Southeast Asian economies. On the contrary, the size of import expansion in the area for which some South Asian and Southeast Asian economies have interests is limited. For example, the sizes of expansion for fish (SITC 03), cork and wood (SITC 24) and pulp (SITC 25) are estimated to be in the range of \$1-2million. Therefore, we may conclude that China's liberalization schedule is biased toward the import of capital intensive products and provides benefits to relatively advanced economies in the Asia-Pacific region.

**Table IV-6 Trade Weighted Tariff Reduction Schedule and Expected Import Expansion for Selected Product Groups**

(\$1,000, %)

| SITC | Import Value | Import Expansion | Current Rate | Bound Rate | SITC | Import Value | Import Expansion | Current Rate | Bound Rate |
|------|--------------|------------------|--------------|------------|------|--------------|------------------|--------------|------------|
| 00   | 54,417       | 0                |              |            | 53   | 1,122,383    | n.a.             |              |            |
| 03   | 667,363      | 1,001.04         | 22.79        | 10.17      | 57   | 8,182,055    | 29,864.5         | 16.51        | 6.50       |
| 04   | 735,398      | n.a.             |              |            | 61   | 1,991,442    | 9.5              | 10.44        | 7.47       |
| 05   | 353,673      | n.a.             |              |            | 63   | 1,001,968    | 2,655.2          | 13.09        | 4.93       |
| 06   | 172,263      | n.a.             |              |            | 64   | 3,423,184    | 22,079.5         | 14.09        | 5.61       |
| 08   | 1,405,060    | n.a.             |              |            | 65   | 11,081,885   | 40.94            | 18.59        | 8.97       |
| 23   | 790,154      | n.a.             |              |            | 66   | 1,409,532    | 19,592.4         | 11.74        | 9.96       |
| 24   | 975,363      | 2,389.6          | 3.40         | 1.22       | 67   | 6,488,848    | 6,164.4          | 10.05        | 5.81       |
| 25   | 1,094,518    | 1,587.1          | 1.00         | 0.10       | 72   | 8,294,663    | 116,954.7        | 12.11        | 2.50       |
| 26   | 2,401,785    | 81.7             | 14.48        | 7.14       | 73   | 2,596,283    | 36,607.5         | 10.64        | 8.25       |
| 27   | 270,754      | 1,827.6          | 3.73         | 3.70       | 74   | 6,284,194    | 88,607.1         | 14.98        | 6.98       |
| 28   | 3,293,609    | 6,587.2          | 2.00         | 1.37       | 75   | 6,036,217    | 150,301.8        | 10.31        | 0.45       |
| 33   | 5,882,205    | 16,470.2         | 4.53         | 3.19       | 77   | 16,683,891   | 83,419.4         | 9.97         | 3.70       |
| 34   | 824,040      | 1,112.4          | 6            | 3          | 78   | 1,986,130    | 9,930.65         | 26.14        | 11.49      |
| 42   | 1,384,565    | 18,553.17        | 25           | 15         | 81   | 108,417      | 64.9             | 20.20        | 13.68      |
| 51   | 3,491,868    | 19,379.8         | 10.33        | 5.57       | 84   | 1,071,925    | 1,822.2          | 32.82        | 15.77      |

Table IV-7 summarizes impacts on exports by individual AP developing economies. The extent of expected import expansion is of limited size for South Asian economies, mainly due to limited transactions between South Asia and East Asia in general. India is expected

to have considerable opportunities only for the export of fixed vegetable oils (SITC 42) and non-metal mineral manufactures (SITC 66). However, it should be noted that the assessment of import expansion effects for individual economies could underestimate export opportunities because it is based on the current levels of market shares. Currently insignificant export performance in the Chinese market is one reason for the limited size of expected import expansion for these economies. Considering South Asian economies' significantly higher shares in the U.S. market for their major exports, these economies may have greater potential than the current presence in the Chinese market for light-industry manufactures. For instance, while Bangladesh lost its share in the Chinese market for the export of manufactured goods of SITC 6, India and Pakistan's shares increased noticeably during 1995-1998.

Greater export opportunities are expected for Southeast and East Asian economies. First, Malaysia and Philippines share the same interests with India for exports of fixed vegetable oils. The expected increases amount to \$96 million for Malaysia and \$6.3 million for Philippines. Second, all Southeast Asian economies are expected to gain from the increased export of electrical equipment (SITC 77). Also, Malaysia and Thailand will be able to increase exports of industrial equipment (SITC 74) considerably.

Korea and Chinese Taipei seem to be the greatest beneficiaries of China's tariff liberalization. The markets in which both economies can expect considerable export opportunities include those for plastics (SITC 57), paper (SITC 64), textile yarn, iron and steel (SITC 67), metalworking machinery (SITC 73), industrial equipment (SITC 74). As far as Korea is concerned, organic chemicals (SITC 51), industry special equipment (SITC 72) and electrical equipment (SITC 77) are important areas for exports.

**Table IV-7. Export Opportunities for Individual Economies by Product**

(\$1,000)

| SITC | South Asia |         |          | Southeast Asia |          |             |           | East Asia |          |
|------|------------|---------|----------|----------------|----------|-------------|-----------|-----------|----------|
|      | Bangladesh | India   | Pakistan | Malaysia       | Thailand | Philippines | Indonesia | Korea     | Taiwan   |
| 03   | 11.0       | 26.5    |          |                |          |             |           |           |          |
| 04   |            |         |          |                |          |             |           |           |          |
| 05   |            |         |          |                |          |             |           |           |          |
| 06   |            |         |          |                |          |             |           |           |          |
| 08   |            |         |          |                |          |             |           |           |          |
| 23   |            |         |          |                |          |             |           |           |          |
| 24   |            |         |          | 596.6          | 36.4     |             | 288.9     |           |          |
| 25   |            |         |          |                | 1.7      |             | 37.65     |           |          |
| 26   | 2.0        | 9.5     |          | 10.6           | 27.5     |             | 9.8       |           |          |
| 27   |            | 554.0   |          |                |          |             |           |           |          |
| 28   |            | 762.0   |          |                | 30.8     |             |           |           |          |
| 33   |            |         |          |                |          | 156.8       | 3,903.1   | 8,624.7   | 359.9    |
| 34   |            |         |          |                |          | 112.4       | 104.4     | 483.3     |          |
| 42   |            | 654.2   |          | 96,853.0       |          | 6,305.9     | 24,404.4  |           |          |
| 51   |            |         |          |                |          |             |           | 27,246.3  | 4,388.6  |
| 53   |            |         |          |                |          |             |           |           |          |
| 57   |            |         |          |                |          |             |           | 50,517.7  | 40,731.1 |
| 61   | 2.3        | 10.5    | 3.5      |                |          |             |           | 255.5     | 191.5    |
| 63   |            |         |          |                |          |             | 5,128.1   |           |          |
| 64   |            |         |          |                |          |             | 12,964.9  | 25,691.9  | 13,282.0 |
| 65   | 9.7        | 669.8   | 71.4     |                |          |             | 38.4      | 85.7      | 11.5     |
| 66   |            | 4,582.3 |          |                |          |             |           |           | 0        |
| 67   |            |         |          |                |          |             |           | 7,137.6   | 5,773.6  |
| 72   |            |         |          | 1,126.9        | 243.9    | 102.3       | 214.7     | 14,323.4  |          |
| 73   |            |         |          | 899.4          | 397.0    | 136.7       |           | 15,983.1  | 40,501.3 |
| 74   |            |         |          | 4,761.6        | 6,356.1  | 186.9       |           | 36,039.4  | 58,011.1 |
| 75   |            |         |          | 735.5          | 3,174.9  | 369.6       |           | 766.04    | 2,018.3  |
| 77   |            |         |          | 17,324.6       | 4,213.   | 3,644.8     | 1,585.    | 59,668.5  |          |
| 78   |            |         |          |                |          |             |           | 1,719.1   | 4,210.3  |
| 81   |            |         |          | 14.9           | 12.4     |             |           | 13.4      | 22.5     |
| 84   | 60.4       |         |          |                |          |             |           |           |          |

### 3. Competition between AP Developing Economies and China in Overseas Markets: Some Implications for Textile and Apparel Exports

The Uruguay Round produced an agreement to eliminate quantitative restrictions on trade in textile and clothing imposed by MFA. The phase-out of MFA by 2004 is generally expected to expand exports from developing countries. However, China's accession to the WTO poses one major challenge to AP developing economies as China and other textile exporting economies will have to face real competition with the abolition of bilateral MFA agreements. In other words, the quota system of MFA has protected, at least, each allocated share of textile and apparels exports of individual exporting countries, despite its intrinsic restrictive effects. The abolition of the quotas poses a new uncertainty. That is, it could expose small but protected textile and apparel suppliers to additional competition from other restrained exporters like China. Therefore, it is difficult to predict exactly what the consequences will be of MFA abolition.

**Table IV-8 Major Suppliers of Textile and Clothing to the U.S.**

| Suppliers      | Exports (million M <sup>2</sup> ) |          |          | Share (%) |       |       |
|----------------|-----------------------------------|----------|----------|-----------|-------|-------|
|                | 1997                              | 1998     | 1999     | 1997      | 1998  | 1999  |
| Mexico         | 1555.103                          | 1984.572 | 2253.946 | 13.70     | 15.40 | 16.35 |
| China          | 947.376                           | 910.229  | 905.285  | 8.35      | 7.06  | 6.57  |
| Honduras       | 725.982                           | 798.962  | 889.254  | 6.40      | 6.20  | 6.45  |
| Hong Kong      | 736.450                           | 862.439  | 825.912  | 6.49      | 6.69  | 5.99  |
| Bangladesh     | 671.763                           | 743.516  | 761.217  | 5.92      | 5.77  | 5.52  |
| Chinese Taipei | 589.586                           | 620.643  | 629.124  | 5.19      | 4.82  | 4.56  |
| Korea          | 320.484                           | 460.075  | 521.518  | 2.82      | 3.57  | 3.78  |
| Indonesia      | 393.554                           | 433.677  | 429.858  | 3.47      | 3.37  | 3.12  |
| India          | 315.584                           | 364.260  | 378.998  | 2.78      | 2.83  | 2.75  |
| Thailand       | 283.767                           | 334.885  | 367.966  | 2.50      | 2.60  | 2.67  |
| Sri Lanka      | 322.046                           | 332.451  | 329.720  | 2.84      | 2.58  | 2.39  |
| Pakistan       | 193.656                           | 214.783  | 225.526  | 1.71      | 1.67  | 1.64  |
| Malaysia       | 134.984                           | 162.381  | 182.008  | 1.19      | 1.26  | 1.32  |

Source: U.S. Department of Commerce

Table IV- 8 shows trends for import shares (in terms of volume) of major suppliers in the U.S. textile market. Most top suppliers lost their shares except Mexico and Honduras whose exports receive preferential treatment in the U.S. market. Considering total market shares, Asian developing economies' performances are still impressive. For example, while Bangladesh's market share for all products in the U.S. was far less than 1%, its share of textiles was over 5% in 1999.

In order to assess the impact of MFA phase-out and China's accession to the WTO on exports of AP developing economies, we may have to consider those issues involved in textile trading under MFA such as quota utilization ratio, quality upgrading and production sharing activities.<sup>11</sup>

**Table IV- 9 MFA Quota Utilization Ratio of Asian Suppliers**

| Supplier       | Quota Utilization Ratio |       |       |
|----------------|-------------------------|-------|-------|
|                | 1997                    | 1998  | 1999  |
| Korea          | 49.45                   | 62.07 | 62.29 |
| China          | 81.74                   | 77.23 | 76.63 |
| Hong Kong      | 54.08                   | 65.82 | 61.26 |
| Chinese Taipei | 57.31                   | 59.34 | 59.02 |
| Singapore      | 23.76                   | 22.31 | 25.12 |
| Indonesia      | 82.00                   | 89.75 | 79.30 |
| Thailand       | 67.23                   | 75.17 | 73.43 |
| Malaysia       | 46.63                   | 51.50 | 45.95 |
| Philippines    | 61.94                   | 61.90 | 65.14 |
| Bangladesh     | 82.96                   | 91.14 | 85.03 |
| India          | 90.44                   | 91.96 | 88.60 |
| Sri Lanka      | 59.34                   | 65.25 | 59.36 |
| Pakistan       | 62.06                   | 61.03 | 61.94 |

Source: U.S. Department of Commerce

<sup>11</sup> The U.S. negotiated safeguard is available upon China's accession to the WTO until 2008, four years after the last quotas are set to be lifted by importing countries under the ATC. This will give some time for other developing economies to enhance their competitiveness.

The quota utilization ratio can be used to assess the extent to which the MFA actually restrict trade. Typically, the quota utilization ratio is less than 100%. However, it would be misleading to conclude that the MFA is less restrictive because the quota is not binding. First of all, quota allocation is usually made on the basis of historical background, disregarding changes in the demand side. It results in the disparities in quota utilization among suppliers. For example, the ratios of Korea and Chinese Taipei remain at around 60%, while the ratios tend to be high in the economies of other parts of the Asia-Pacific region. Also, as the quota allocation system allows limited flexibility among categories of textile and clothing, there can easily exist both binding and non-binding quota at the same time, leading to a lower utilization ratio. Therefore, lower ratios themselves may reflect restrictions imposed on textile trade by the MFA. The fact that the utilization ratio of China continued to decrease during the past three years may be a sign of advancement of the Chinese textile industry and its competitiveness, which may take effect after the total phase-out of the MFA. For instance, the Chinese apparel industry is moving toward the production of quality-oriented and high value-added products. The change is led by producers in Hong Kong. Hong Kong's return to Chinese rule in 1997 has boosted China's textile and apparel industry.<sup>12</sup> Quality upgrading and product diversification under quota through changes in product mix is easily found when suppliers are faced with volume restrictions.

Recently, the United States enacted the Trade Promotion Act (TPA) which is intended to apply preferential tariffs to Central American countries in lieu of Caribbean Basin Initiatives. As a result, apparel imports from these areas will be subject to the same rates as imports from Mexico. It is expected that exports of yarns and fabrics to the U.S. will expand by promoting production sharing activities among U.S. wholesalers, producers and assembly lines in Central American countries. It is therefore expected that the competitiveness of apparel produced by the production sharing activities will greatly increase. Particularly, the act is expected to help the Central American countries compete with imported apparel from Asia. Since the launch of NAFTA, apparel imports from other

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<sup>12</sup> USITC (1999)

NAFTA economies increased 585%, while imports from CBI and Asia increased about 250%. Apart from China's accession to the WTO, the TPA has an important implication for AP developing economies. That is, it is plausible that foreign direct investment activities may dramatically respond to this act. It does not necessarily mean that production capitals will move from Asia to Central America. Rather, more foreign direct investment will search for other areas of Asia like Cambodia, Laos and Myanmar, which have strong comparative advantages in labor cost and quality.

In order to assess the competitiveness of AP developing economies in textile and apparel trade in the U.S. market, we conducted the constant market share analysis (CMS) for the period 1997-1998, the results of which are reported in <Tables IV-10> and <Tables IV-11>. According to the CMS model, the proportionate increase in exports of a commodity over time is composed of the following factors: market growth effect, production mix effect and residual effects which might reflect price competitiveness, quality changes and other managerial skills.

According to Table IV-10, there seems to be a common pattern. All suppliers responded quickly to the changes in demand. On the other hand, the negative signs on the product mix effect imply that Asian economies did not catch up with changes in demand structures very well. Economies differ from each other with respect to the residual "competitiveness" effects. The positive signs for Korea and Chinese Taipei seem to be attributable to price competitiveness benefitting from drastic depreciation of their currencies after the crisis. One of the most interesting aspects of this table is that the less developed Southeast Asian economies demonstrated impressive competitiveness. Actually, the competitiveness factor contributed to most of the export growth. On the other hand, South Asian economies are heavily dependent on growth of demand. It is not clear yet whether geographical diversification of production activities in this sector, which is occurring in Southeast Asia, will strengthen in the future. However, increased competition in the world textile and clothing market with the phase-out of the MFA would lead to AP regionwide reorganization of production activities.



**Table IV-10 Factors of Export Growth: MFA Category Total (U.S.)**

|                       | <b>Total Growth</b> | <b>Growth Effects</b> | <b>Product Mix</b> | <b>Competitiveness</b> |
|-----------------------|---------------------|-----------------------|--------------------|------------------------|
| <b>Korea</b>          | 177.377             | 107.552               | -35.308            | 105.134                |
| <b>China</b>          | 92.322              | 200.148               | -70.061            | -37.669                |
| <b>Chinese Taipei</b> | 80.033              | 122.559               | -37.88             | -4.586                 |
| <b>Indonesia</b>      | -67.442             | 100.399               | -29.133            | -138.658               |
| <b>Thailand</b>       | 120.457             | 102.693               | -32.699            | 50.512                 |
| <b>Malaysia</b>       | 58.004              | 27.14                 | -7.81              | 38.687                 |
| <b>Philippines</b>    | 109.682             | 81.945                | -26.022            | 53.8                   |
| <b>Cambodia</b>       | 67.380              | 11.111                | -3.03              | 58.669                 |
| <b>Myanmar</b>        | 27.394              | 4.709                 | -1.392             | 23.907                 |
| <b>Vietnam</b>        | 6.263               | 1.784                 | -0.33              | 6.82                   |
| <b>Macau</b>          | 51.662              | 23.279                | -6.74              | 35.134                 |
| <b>Bangladesh</b>     | 44.982              | 89.15                 | -24.024            | -20.1                  |
| <b>India</b>          | 65.784              | 111.616               | -28.108            | -17.667                |
| <b>Sri Lanka</b>      | 32.402              | 54.347                | -15.874            | -6.044                 |
| <b>Pakistan</b>       | 61.125              | 152.786               | -34.896            | -56.761                |

**Table IV-11 Factors of Export Growth : Total Apparel (U.S.)**

|                       | <b>Total Growth</b> | <b>Growth Effects</b> | <b>Product Mix</b> | <b>Competitiveness</b> |
|-----------------------|---------------------|-----------------------|--------------------|------------------------|
| <b>Korea</b>          | 404.429             | 204.412               | -47.451            | 247.566                |
| <b>China</b>          | -59.434             | 523.736               | -71.181            | -511.74                |
| <b>Chinese Taipei</b> | 72.528              | 299.349               | -112.251           | -114.428               |
| <b>Indonesia</b>      | 52.258              | 213.762               | -99.686            | -61.715                |
| <b>Thailand</b>       | 228.442             | 192.144               | -87.006            | 243.853                |
| <b>Malaysia</b>       | 83.013              | 59.623                | -28.405            | 51.823                 |
| <b>Philippines</b>    | 246.191             | 164.768               | -76.582            | 158.083                |
| <b>Cambodia</b>       | 145.089             | 7.541                 | -4.258             | 140.559                |
| <b>Myanmar</b>        | 42.76               | 7.589                 | -3.382             | 38.311                 |
| <b>Vietnam</b>        | 8.841               | 3.686                 | -2.22              | 6.58                   |
| <b>Macau</b>          | 101.197             | 44.119                | -21.58             | 78.68                  |
| <b>Bangladesh</b>     | 146.009             | 191.128               | -105.058           | 60.03                  |
| <b>India</b>          | 163.693             | 246.435               | -157.02            | 74.395                 |
| <b>Sri Lanka</b>      | 80.663              | 119.844               | -53.034            | 13.91                  |
| <b>Pakistan</b>       | 418.637             | 281.461               | -169.169           | 306.332                |

The results of CMS analysis on apparel are reported in Table IV-11. The results from apparel exports are similar to those for total textile trade. Again, AP developing economies do not seem to have quickly responded to the changes in demand structure. The product mix effects are all negative. However, the South Asian economies show positive signs in competitiveness factor although the extent of this factor's contribution to export growth is far below Southeast Asian less-developed economies. This fact could answer the question of why Hong Kong manufactures are moving to Vietnam, Laos and Cambodia recently, when a massive restructuring is expected with the more liberalized trade environment for textile and apparel in coming years.

## **. Policy Implications**

### **1. Trade and Investment Liberalization**

In order for developing countries to compete better in the Chinese market, it is necessary that they not only utilize their most favorable comparative advantage in natural resources and cheap labor but also acquire advanced technology. This can be achieved, first of all, by opening their own domestic markets. When opening domestic markets, countries tend to make better use of cheap labor and natural resources in response to competition. Therefore, they will strengthen international competitiveness in sectors where they have comparative advantage. Developing countries can also gain technology transfers from developed countries and improve corporate management; that is, they acquire by-products, such as advanced technology and managerial skills to be used for high value-added items. As a result, developing economies will become more stable and competitive, which will lead to sustainable economic growth. This is a major reason why developing countries should proceed with trade and investment liberalization in a more progressive way. Specifically, policy guidance should be as follows.

First, they should actively react and adjust to the multilateral trading system. Under the system where some advanced countries such as the United States, EU, Japan and Canada have led the world economy, developing countries have responded to the system in a passive and inactive way. However, with China's WTO entry, developing countries will exercise a stronger influence under the auspice of China such that they can devote themselves to the multilateral trading system more actively, thereby contributing to the expansion of world trade. In doing so, rather than negatively responding to trade and investment liberalization, they have to suggest productive ideas for a better scheme for trade and investment liberalization so that they can benefit from the system. In addition, they will have to comply with international norms related to trade and investment liberalization. It is worth emphasizing that they have to react to the multilateral trading

system positively not only when establishing international norms but also when implementing them.

Second, it seems desirable for developing countries to actively participate in regional economic cooperation programs designed to promote trade and investment liberalization. As is well known, the number of regional trade agreements has been increasing recently. According to the WTO, trade agreements within GATT/WTO recorded 107 as of April 1999. Among them, 77 new agreements were made during the nine years since 1990, accounting for 72% of total regional trade agreements. Moreover, assuming that the number of agreements not yet reported to the GATT/WTO exceeds 100, regionalism is tending to become fairly universal. In the past, free trade agreements were made mainly either among developed or among developing countries. In recent years, however, the free trade agreements between developed and developing countries are prevalent. Thus, it seems that the stage of development is not a matter in forming such agreements. While there exist controversies over the relationship between regionalism and multilateralism, it is well known that regionalism is not necessarily detrimental but rather complementary to multilateralism in achieving trade liberalization. Regional trade agreements usually contain a higher level of obligations for liberalization than multilateral trade agreements. Thus, they can pursue a more advanced liberalization scheme with a smaller number of nations.

Third, bilateral investment treaties(BIT) are also worth mentioning for similar reasons; they may help the developing countries attract foreign investment and adopt technology from developed countries in a more stable manner. With China's entry to the WTO, developed countries may possibly desire to contract an FTA or BIT with countries neighboring China in order not only to make use of their cheap labor and natural resources, but also to penetrate more aggressively into the Chinese market in the future. Developing countries need to take this chance for attracting foreign capital and advanced technology.

Lastly, it should be emphasized that domestic regulatory reform is one of the fundamental

and necessary conditions for trade and investment liberalization. The proper idea is that developing countries should make domestic regulations consistent with international norms. They have to realize that such liberalization is to ensure not only better market access but also fair competition between domestic and foreign competitors. They can pursue trade and investment liberalization successfully by complying with international norms and ensuring transparency in domestic institutions.

## **2. Response to New Trade Issues**

It is very difficult to predict exactly when new trade issues will be incorporated into the multilateral trading system. However, it is highly likely that the process may be accelerated as China joins the WTO. Since new trade issues may be one of important tools for globalization of the world economy, developed countries will continue to force China to reform its relevant institutions. Then, those issues will remain persistently controversial in various international fora as long as China retains an unfair and untransparent economic structure in the private as well as public sectors.

Following up the recent discussions in various international fora, considerable work seems to remain for the WTO to reach an agreement on multilateral rulings of those issues. The most immediate priority is to narrow down the differences in the views on new trade issues between developed and developing countries. Even though multilateral rules on new trade issues are expected to contribute to enhancing the world economic and social welfare in the long run, they may have negative economic impact on the developing countries in the short run.

First of all, strengthening of environmental disciplines by multilateral environment standards will raise production costs of firms, requiring a substantial change in the production process and technology. Furthermore, a part of those costs may be transferred to consumers, ultimately raising consumer prices as well. Similar effects are expected in

relation to the issue of labor standards. Upward adjustments of labor standards may cause shortages in labor supply, raising labor costs. Ensuring the core labor standards may induce higher wages through enforcement of workers' collective bargaining status *vis-a-vis* employers.<sup>13</sup>

Multilateral rules of competition policy and transparency in government procurement related to anti-corruption are also difficult for developing countries to accept, at least in the short run when their domestic system and practices are considered. Not many developing countries have yet adopted competition policy in their domestic economy. Much opaqueness remains in their businesses as well as in their public sectors. Reform of systems and practices in those areas will certainly cause huge social as well as economic adjustment costs. Even liberalization in investment will be a very difficult task for some developing countries. They want to selectively open areas of foreign investment which are consistent with their development strategy. Protection for certain domestic industries may be another reason why they are unwilling to liberalize investment.

Considering all of this, developed countries should give sufficient time for developing countries to adapt to new trade issues and assist them with relevant technology and know-how. Developing countries, in exchange, should prepare to take measures and implement them.

Primarily, developing countries should expand investment for the protection of the environment. It is obvious that the issue will become more important as overseas sales of commodities unqualified to environment standards are not permitted. They should engage in preventive environment policy and assist domestic firms to the greatest extent in building up an environment-friendly workplace. The government should set up rules or administrative guidelines to implement with some reservation period.

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<sup>13</sup> The relationship between labor standards and trade has been examined by Rodrik (1997). The study shows that lax labor standards are highly associated with lower costs in a cross-section of countries.

It is likely to take a great deal of time to set international norms for labor issues because developing countries still strongly oppose it. However, it may be possible that a minimum level of guideline for labor standards could be set up based on carefully researched results. Developing countries should take more progressive action on labor issues so that they can continue to be able to export commodities in which they have comparative advantage. Adjustment to international labor standards will lead to higher productivity, better quality control and export competitiveness.

It is also likely that international norms and standards will be adopted in the area of competition policy, anti-corruption and corporate governance. It is certainly not an easy task for developing countries, but they may not be able to refuse adoption of such issues for long because these areas are directly linked with a nation's overall image and therefore affect their exports. When international norms are made for those issues, monopolistic business practices and untransparent government procurement procedures, which are fairly typical in developing countries, will be strictly governed.

### **3. Industrial Restructuring**

As the world economy becomes globalized and the Chinese economy is integrated into the multilateral trading system, developing countries may experience many difficulties in the short run. Their economies will stagnate in poverty unless they can overcome the problems of lack of industrial technology, over-supply of labor, inconsistencies with international norms and inefficiencies in economic management. In order to resolve those problems and to compete better in both domestic and China's markets, they have to pursue a dramatic industrial restructuring.

In principle, they have to strengthen export competitiveness, building up knowledge-based industries. Technology should be developed to improve non-price competitiveness. In many

areas, major Chinese exports compete with those of developing countries. Such competition can cause a dilemma for developing countries not only in their exports to China or to developed countries, but also in their domestic sales. Their major export products such as agricultural goods, textiles, raw materials and cheap manufactured commodities are already price competitive. However, the problem is that Chinese products are also fairly price competitive as well. Unless developing countries improve competitiveness in non-price factors such as quality, function, design, packages, etc., their export market will be rapidly encroached upon by Chinese products. That is why developing countries should promote industrial restructuring and build up knowledge-based industries. At present, developed countries are already moving towards the economy of knowledge-based industries. The gap of technology and wealth will deepen between developed and developing countries unless developing countries try to build up knowledge-based industry. While there exists no clear definition of knowledge-based industry yet, it is perceived that knowledge-based industries include conventional industries as well, if they can commercialize high-value added items such as fashion clothing and special footwear. Thus, developing countries can establish a knowledge-based industry structure, first by utilizing their conventional industries, and then by developing industries with a higher class of technology.

Second, developing countries have to foster the service industry. The service industry can be fostered not only by developing their own national service sectors but also by inviting foreign direct investment into their service industry. Although features of the service industry differ depending on economic development level, it is in general highly correlated with the manufacturing sector. So, it can contribute greatly to economic growth, production expansion and international competitiveness. The service sectors on which the agricultural and manufacturing industries are highly dependent are as follows: distribution services such as retail/wholesale, storage and transportation; financial services such as banking and insurance; and professional services such as engineering, construction and legal services. As an economy develops to higher levels, the service industry and other industries tend to become more dependent on each other. In consequence, without development of the service



industry, economies as a whole can not acquire international competitiveness in the future.

Third, developing countries should restructure industries in order to effectively respond to new trade issues. In case where international norms on new trade issues are made in the short run it is certain that developing countries should pay expensive adjustment costs. Therefore, they should make restructuring plans as early as possible and implement them sincerely. In specific, they should put great efforts into constructing a structure of environment-friendly domestic industries, considering it as a fundamental survival issue. At the same time, they have to establish business environments consistent with the market economy. In particular, they should consolidate business practices where small and medium-sized enterprises enjoy free competition and fair market condition. In doing so, they have to make rules and promote effective competition policy. They should also dramatically reform the public sector, which is considered a somewhat problematic area in developing countries. The major task is to eliminate corruption networks between the government and firms and privatize public firms for efficient management.

Lastly, developing countries should realign their industrial support system so that it can perform its proper function of facilitating the sustainable economic growth. If the system functions properly, developing countries may be able to explore new industry areas, driving economic growth with dynamic comparative advantages. In reality, the industrial support policies have been severely restrained since the launch of the WTO under the “Agreement on Subsidies and Countervailing Measures.” According to this agreement, all but the least developing countries are prohibited from using industrial support policies which directly affect exports. Furthermore, even in the case where certain subsidies do not affect exports, those granted to a particular industry to improve competitiveness are restrained in their use if they cause injury to trading partners. In consequence, developing countries should reform their industrial support system so as to avoid intensive support for a particular industry, which may distort the trade structure directly or indirectly. Rather, they should give limited support under the guidance of international norms either when the industry concerned is at

an initial or declining stage. Also, they have to pay more attention to areas such as social infrastructures, R&D, regional development, and environmental protection so that overall industrial sectors benefit. To sum up, it is important to understand that even if certain subsidies need to be provided to achieve a specific development goal, they should be granted to an extent that does not distort trade structure.

#### **4. Human Resource Development**

Abundant labor in developing countries in the Asia-Pacific region certainly plays a major role in achieving economic growth. While potentiality for economic growth in many developing countries of the region lies in rich human resources, they remain quite underdeveloped even when compared to China; they are not fully utilized with an over-supply of labor but short of skilled labor. A well-qualified labor force can be secured only through systematic education and job-training.

Developing countries need to secure the capacity to adjust to changes in the world economy by expanding investment in education. Taking into account that the agricultural sector is the biggest portion of the economy of developing countries in the Asia-Pacific region, they should provide rural areas at least with basic education – primary or secondary education – so that the labor force can move to manufacturing or service sectors that have higher productivity. Then the labor force will be easily nurtured with skills in various sectors, raising labor productivity in the agricultural sector as well. It is, of course, necessary that vocational training courses be provided to the workers so that they can be cultivated as professionals in the related fields. Constant vocational training should help firms improve the ability to develop new items and to meet consumers' needs more quickly than other firms in competition. They also have to enhance the skills or knowledge of managers and entrepreneurs. Well-skilled managers or entrepreneurs will bring out more creative ideas not only in managing firms but also in establishing a legal and institutional infrastructure. In that respect, it is important to provide various programs where they are educated not

only on expertise or managerial skills in the related areas but also on world economic issues in general.

In order to support all of this, flexibility of the labor market should be ensured. The newly industrialized countries of Asia such as Korea, Malaysia, Chinese Taipei and Thailand were able to achieve high economic growth because millions of farmers moved into industrial and other non-agricultural sectors of higher productivity over the past quarter century. There are tens of millions more working on farms in India, Indonesia and Vietnam, implying that the growth potential from the transfer of rural labor to more productive jobs remains strong in those countries.<sup>14</sup> Labor flexibility will be ensured when workers are well-informed about the labor market. Employees should be informed of the best employment opportunity for their abilities, and employers should acquire in-time information of proper workers in need. For that purpose, an institutional framework should be established so that such information may be available all the time to employees and employers.

Lastly, the importance of trade and investment liberalization should be reemphasized in relation to human resources development. Trade and investment liberalization can work as an instrument to improve the labor productivity of a nation through intensified international competition. Advanced technology, ideas, institutions and practices can be transferred from foreign firms or consumers only when the economies are open. Domestic firms can acquire technologies embodied in import materials and components, which will contribute to human resource development in the end. Foreign direct investment, in particular, can bring up skilled labor and professional managers in more direct ways.

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<sup>14</sup> OECD (1997), p. 64.

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