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U.S. AGRICULTURAL EXPORTS**

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ABSTRACT: China's accession to the WTO has been welcomed by a broad range of U.S. agricultural interests. The WTO agreement will lower tariffs and other barriers, and increase market access, but the actual benefits to U.S. exporters will depend on the competitiveness of U.S. exports with those of other countries and on China's implementation of WTO rules. Analysis by the U.S. Department of Agriculture indicates immediate gains in export sales for U.S. agriculture, gains that will increase over time as market access expands and as Chinese economic growth boosts demand for imported agricultural products. However, some observers express less optimism, indicating that while U.S. exports to China should expand "in theory," in practice exporters will face several hurdles which must be overcome in order to reach the full potential of the Chinese market. This paper adds to USDA and other analyses of China's export potential by discussing the status of China's WTO implementation for agriculture, and provides a qualitative assessment of the potential for U.S. agricultural exports to China over the next few years.

¹ This paper represents solely the views of the authors and is not meant to represent the views of the U.S. International Trade Commission or any of its Commissioners. Contributions to the paper were also made by Joanna Bonarriva, Alfred Dennis, Brad Gehrke, Timothy McCarty, Douglas Newman, John Reeder, Rose Steller, and George Serletis. Please direct all correspondence to Jonathan Coleman, Office of Industries, U.S. International Trade Commission, 500 E Street, SW, Washington, DC 20436, telephone: 202-205-3465, fax: 202-205-2384, email: jcoleman@usitc.gov.

CHINA'S ACCESSION TO THE WTO AND U.S. AGRICULTURAL EXPORTS

INTRODUCTION

Current analysis indicates large gains in export sales for U.S. agriculture owing to China's accession to the World Trade Organization (WTO), gains that will increase over time as market access expands and as Chinese economic growth boosts demand for imported agricultural products.² However, the extent to which these export gains are realized will depend on several factors. These include China's implementation of its WTO commitments, Chinese domestic agriculture and food regulations affecting imported products, and competition U.S. exporters will face from other exporting countries in the Chinese market. The competitiveness of U.S. agricultural products vis-à-vis competitors will depend on factors such as production and marketing efficiency, U.S. domestic policies, exchange rates, and transportation.

This purpose of this paper is to summarize developments in areas that will have key roles in determining the level and extent of future increases in U.S. exports to China. The paper includes the following sections: a summary of China's market access commitments within the WTO, including a discussion of how China is implementing its commitments; a discussion of China's food regulations which impact imports; and an evaluation of U.S. competitiveness in the Chinese market vis-à-vis its major international competitors. We conclude with a qualitative assessment of the likely impacts of these factors on U.S. agricultural exports to China over the next few years.

China's WTO accession agreement will have a differential impact on the sales of various U.S. agricultural products, owing to both the details of China's agreement for individual items (e.g., cotton, soybeans) and the competitive factors facing U.S. farmers in the Chinese market from third-country competitors. In nearly all cases, Chinese consumers are sensitive to price when making food purchases; consequently, imports from various sources of comparative quality compete for sales almost solely on price. For example, while wheat imports from all sources have established a niche among Chinese millers and food manufacturers, U.S. wheat sales are not expected to grow considerably under the WTO accession agreement because lower-cost Canadian and Australian wheat are gaining market share. Similarly, analysts do not expect significant changes in U.S./China rice trade since existing competitive

² China's market access commitments under the WTO could potentially create huge opportunities for U.S. exports of agricultural products to China. This potential has been illustrated by recent empirical work conducted by the U.S. Department of Agriculture (USDA). For example, using a policy simulation model, the USDA indicates that if accession had not taken place, China would be a net exporter of corn of about \$426 million annually during 2000-09. With accession, China is expected to be a net importer of about \$71 million annually, a difference of almost \$500 million. Similarly, China's annual wheat imports are expected to increase by \$484 million during 2000-09 as a result of WTO accession (that is, \$243 million without accession, \$727 million with accession). China's accession will also substantially increase its imports of cotton, according to USDA estimates. The baseline (without accession) projects annual imports of \$429 million during 2000-09, which would increase by \$328 million to reach \$757 million with the assumption of WTO accession. Overall, China accession will boost imports of soybean oil and soybean meal, which are expected to be higher by \$221 million and \$348 million, respectively. Growth in these imports is offset to a certain extent by a drop in the level of China's imports of soybeans which are expected to decline by almost \$400 million annually during 2000-09. Analysis by Koo (wheat) and Jiang *et al.* (soybeans) also indicates that the benefits of China's WTO accession are substantial. Sources: USDA, ERS, "China's WTO Accession Would Boost U.S. Ag Exports & Farm Income," *World Agriculture & Trade, Agricultural Outlook*, Mar. 2000; Koo, W. W., "The Impact of China's Accession into the WTO on the U.S. Wheat Industry," *Agricultural Economics Report no. 440*, Northern Plains Trade Research Center, Fargo, ND, June, 2000; and Jiang J., N.E. Piggott, and M.K. Wohlgenant, "Trade Policy Changes in China: Implications for the U.S. Soybean Sector," paper presented at the 2001 Australian Agricultural and Resource Economics Meeting, Adelaide, Australia, Feb. 2001.

factors favoring Thailand and Vietnam over U.S. rice growers in the Chinese market likely will continue. In cases where the United States remains cost-competitive vis-a-vis other Chinese imports, such as cotton, corn, soybeans and soybean products, pork, and poultry, nontariff barriers such as tariff-rate quota (TRQ) administration (corn and cotton), restrictions due to sanitary and phytosanitary (SPS) concerns (poultry and tobacco), regulations governing genetically modified organisms (GMOs) (corn, soybeans and soybean products), and China's commitment to eliminating export subsidies (corn) will likely play an important role in determining the level of U.S. exports.

BACKGROUND

In December 2001, China became the 143rd member of the World Trade Organization (WTO), concluding an accession bid that began in the mid-1980s (box 1). China's entry into the WTO could potentially have a profound effect on world trade in both goods and services. In 2000, China was the world's 7th leading exporter and 8th largest importer of merchandise trade, while in services it was the world's 12th leading exporter and 10th largest importer. Among the sectors most significantly impacted by the accession will be agriculture. With a population of over one billion people and per capita income increasing at about 10 percent annually, China has a huge potential for increasing its consumption of food and fiber in the future. China's agricultural imports have grown steadily over time. During the past 20 years, for example, U.S. agricultural exports to China increased from almost nothing to \$1.7 billion in 2001.

Box 1. China's Accession to the WTO

1986	China applies for membership to the General Agreement on Tariffs and Trade (GATT)
1987	GATT Working Party on China's accession formed
1995	WTO replaces the GATT under the Uruguay Round Agreement
1995-97	China makes several trade reforms, including tariff reductions in some goods categories and restructuring of the state enterprise sector
Nov. 1999	U.S.-China bilateral market access agreement concluded
May 2000	EU-China bilateral market access agreement concluded
Nov. 2001	WTO Report of the Working Party on the Accession of China
	WTO members formally approve China's accession at WTO Ministerial Conference in Doha.
Dec. 2001	China becomes a full WTO member

In 2001, China's agricultural imports reached \$9.2 billion compared with \$8.4 billion in 1997, up considerably from \$6.5 billion in 1999 (appendix table A-1).³ During this period, bulk and intermediate products each accounted for about 40 percent of China's agricultural imports, while consumer-orientated

³ Agricultural imports are defined in this study as those covered by HS Chapters 1-24 (excl. Ch 3, 0507-0510, 1604, 1605, 2402, 2403), 4101, 4102, 4103, and 5201. The source of the data is Chinese Customs statistics.

products made up the remaining 20 percent. North America supplied roughly one-third of China's imports between 1997 and 2001, South America accounted for almost 25 percent, and other Asian countries for 20 percent (table A-2). The United States is the most important supplier of agricultural products to China, accounting for almost 27 percent of China's agricultural imports. By far the most important Chinese agricultural imports from the United States are soybeans (table A-3).

To gain WTO membership, China made several concessions that fundamentally altered its domestic and trade policy for agricultural products. For example, China agreed to limit and incrementally reduce its level of trade-distorting domestic agricultural support and also agreed to immediately eliminate all export subsidies on agricultural products. In market access, China pledged to lower average agricultural tariffs from 22 percent to 17.5 percent by 2004, with certain products of most importance to the United States dropping from 31 percent to 14 percent. Also, new market access opportunities were created by establishing TRQs on commodities traditionally handled by state-trading enterprises (for example, grains and oilseeds), and by committing to allow a portion of the quota amount to be administered by private sector traders. China also consented to abide by rules outlined in the WTO SPS agreement, namely that barriers to trade associated with SPS concerns should be based on "sound science."

CHINA'S MARKET ACCESS COMMITMENTS UNDER THE ACCESSION AGREEMENT

Prior to WTO accession, access to China's agricultural markets was tightly controlled by the government through several commodity-specific state trading enterprises (STEs). Absolute import quotas existed for sugar, cotton, and tobacco, while TRQs existed for a variety of other agricultural products. For products not subject to absolute import quotas or TRQs, STEs had the leeway to set their own internal import quotas, and often access levels were determined by provincial supply and utilization rather than by market factors. According to U.S. exporters, China's import policies were highly non-transparent in terms of access availability, forcing them into the position of price takers.

China made significant concessions with respect to market access for agricultural products to become a member of the WTO. Absolute import quotas were eliminated, TRQs were eliminated for a number of products and made subject to tariffs only (for example, barley, soybeans, rapeseed, peanut oil, sunflower seed oil, corn oil, and cottonseed oil), TRQs were introduced for other sensitive agricultural commodities, and private traders were granted access to a portion of the TRQs. China scheduled TRQs with the WTO for the following products: wheat, corn, rice, soybean oil, rapeseed oil, palm oil, sugar, and cotton. China also agreed to liberalize its trading regime through the allocation of increased trading shares to private importers for selected TRQ categories. In addition, China agreed to reallocate unused portions of the TRQ by STEs to nonstate trading enterprises that had been designated the right to trade. Furthermore, China agreed to simplify the administration of the TRQs through the creation of "uniform administration," administer a consistent national allocation and reallocation policy for TRQs, and not establish a separate process at provincial levels.⁴ China guaranteed that a single, central authority would be responsible for all decisions regarding all allocations and reallocations to end-users. Table 1 provides the initial and final TRQ levels and shares of TRQ allocations to STEs.

⁴ The Report of the Working Party of the Accession of China is found at www.wto.org, WT/ACC/CHN/49, Oct. 1, 2001.

Product-Specific Market Access

In terms of product-specific market access, China's TRQ for wheat will reach 8.5 million metric tons (MT) in 2002, increasing to 9.6 million MT in 2004 (table 1). This compares with actual imports during 1999-2001 of only 721,000 MT. China will also allow 10 percent of imports to be allocated to nonstate trading enterprises. Under the WTO agreement, China will establish in-quota tariffs of less than 10 percent, while over-quota tariffs are being reduced to 65 percent from rates as high as 114 percent. China's corn market was almost completely closed to imports over the past 3 years, with imports averaging about 41,000 MT annually. In 2002, China has committed to importing 5.8 million MT of corn rising to 7.2 million MT in 2004 and beyond, with nonstate trading enterprises administering as much as 40 percent of the imports by 2004. China is opening its market to rice imports up to 2.7 million MT by 2004. This is more than ten times the level of imports during 1999-2001. Like wheat and corn, over-quota tariffs on rice are being reduced from 114 percent to 65 percent over the implementation period, while in-quota rates will be 10 percent or less.

Table 1
TRQ commitments and share of STE ownership

TRQ category	Annual average imports	Initial TRQ	Final TRQ	Change initial-final	Initial STE share of TRQ	Final STE share of TRQ	Implementation period
	1999-2001						
	1,000 metric tons			Percent			Year
Wheat	721	7,884	9,636	22	90	90	2004
Corn	41	5,175	7,200	39	71	60	2004
Rice, short & medium grain . . .	244	1,662	2,660	60	50	50	2004
Rice, long grain	¹	1,662	2,660	60	50	50	2004
Soybean oil ²	394	2,118	3,587	69	42	10	2005
Palm oil ²	1,368	2,100	3,168	51	42	10	2005
Rapeseed oil ²	64	739	1,243	68	42	10	2005
Sugar	763	1,680	1,945	16	70	70	2004
Cotton	55	781	894	15	33	33	2004

¹ Rice imports of 244,000 metric tons under the category "rice, short & medium grain" includes long grain rice as well.

² Tariff-rate quota to be eliminated on 1 January 2006.

Source: Schedule CLII—People's Republic of China, Part I, Section I-B.

Opportunities for cotton exporters are expected to be improved as a result of establishing TRQs. During the past 3 years, China's cotton imports amounted to about 51,000 MT annually. Under the terms of their WTO commitments, China agreed to a TRQ amount of 818,500 MT in 2002, increasing to almost 1 million MT in 2004. Moreover, China agreed to allow two-thirds of the quota to be allocated to the private sector. Soybean oil imports up to 3.6 million MT will receive the in-quota rate by 2005, compared to actual imports during 1999-2001 of 394,000 MT annually, with 90 percent of the import rights allocated to private sector traders, and over-quota tariffs as low as 9 percent. The TRQ will be eliminated altogether by 2006. China also created a TRQ for sugar upon WTO accession. The TRQ quantity will reach almost 1.9 million MT by 2004 (compared with actual imports of 763,000 MT annually between 1999 and 2001), of which 30 percent will be administered by nonstate trading enterprises. Other bulk products important to the United States are subject to significant tariff reductions. For example, soybeans, which are not subject to TRQs, will be subject to a bound *ad valorem* tariff of 3 percent, compared with the 2001 MFN rate of 114 percent. The tariff on barley will also drop to

3 percent from the MFN rate of 91.2 percent. The tariff on tobacco bound at 28 percent in 2001 will be reduced to 10 percent by 2004.

China's accession will also impact market access for intermediate and consumer-orientated products. For example, upon accession, China bound its tariff on soybean meal at 5 percent, while tariffs on hides and skins are being reduced from about 10 percent to zero by the year 2004. Most beef products will face a tariff of 12 percent by 2004, compared to a 2001 tariff of 39 percent. Tariffs on many poultry products will be cut by one-half (from 20 percent to 10 percent) once implementation is completed, while tariffs on most pork products are coming down from 20 percent to 12 percent. Tariffs on citrus fruit (an important export of the United States) will drop from an average of 35 percent to 12 percent over the implementation period, and those on grapes will fall from 40 percent to 13 percent.

CHINA'S IMPLEMENTATION OF ITS WTO MARKET ACCESS COMMITMENTS

An evaluation of China's implementation of its WTO commitments indicates a mixed picture. A 2002 tariff schedule was published, which does reflect commitments in the accession agreement, with a few exceptions, such as the tariffs on poultry. However, although China agreed TRQs would go into effect in 2002, interim regulations on TRQ administration were not issued until February, and quotas for many products were not allocated until July 2002.⁵ To follow is a discussion on issues concerning China's administration of its new TRQs. See appendix B for certain 2001 Chinese agricultural tariffs and TRQ staging requirements.

Transparency and Predictability Basis⁶

The scheduling of TRQs within the WTO eliminated the non-transparency of allowable import levels, which represented a major barrier for U.S. exporters to China prior to accession. Traders are now aware of the overall level of access granted via annual TRQs on an annual basis and of the quantity of access designated for private traders versus STEs. While the TRQ access levels are apparent, the experience of U.S. exports to other countries with TRQs shows that the system of TRQ administration can hinder the ability of traders to fully utilize China's market access commitment.

With the publication of interim regulations on TRQ administration procedures comes concern over the compatibility with commitments made as part of the accession package. China divided the right to import under the TRQ into two categories: state trade and non-state trade. The non-state trade category is further divided among STEs and non-state traders with trading rights. End users that have been assigned trading rights may also import directly under the TRQ; however, the regulations do not clearly specify an allocation method for the TRQ shares, but rather generally state that the allocations will be based on factors such as past performance, production capacity, applicable business criteria, or on a first-come, first-served (FCFS) method. Thus, exporters must wait each year for China to announce its chosen method of allocation for the right to import. This appears inconsistent with China's commitment to make the allocation process transparent and predictable.

⁵ China agreed to publish draft regulations by Sept. 15, 2001; however the draft regulations were not released for comment until Nov. 9, 2001. Because of this delay, China failed to allocate all agricultural TRQs to Chinese importers until July 2002.

⁶ Corresponds to paragraph 116 of the Report of the Working Party on the Accession of China (RWP), WT/ACC/CHN/49, Oct. 1, 2001.

Administration by a National Authority⁷

As part of its commitment, China agreed that the role of the sub-national bodies would be limited to administrative operations, not to determining the eligibility of the applicants. According to the interim regulations on the administration of TRQs, the right to import for products subject to a TRQ is allocated via an “Agricultural Product Tariff Quota Certificate” (TQC), which is essentially an import license. However, China has divided the responsibility of allocation of the TQCs among the national and provincial levels.⁸ The State Development Planning Commission (SDPC) is the central authorizing agency on the national level for the allocation of tariff quota shares and 37 Authorizing Agencies (AA) have been approved by the SDPC on the provincial (or city) level to issue the TQCs, which are essentially certificates of eligibility for TRQ allocation. Applications for TQCs are sent to the AA at the provincial level. The AA has the responsibility of receiving applications, verifying applications to assure that they meet the standards, issuing TQCs to approved applicants, and forwarding eligible applications to the SDPC. It is still unclear as to whether an importer must apply in more than one province if the product imported under TRQ will be shipped to multiple provinces. The delegation of authority to provinces leaves room for preferential treatment for selected importers as well as provides the provinces with discretion in deciding which applications should be forwarded to the SDPC. The issuance of the TQCs by a sub-national body appears contrary to China’s commitment that a single, central authority be responsible for decisions regarding allocation and reallocation of TRQs.

Allocation of TRQs by a Single Allocation System⁹

In addition to the dual allocation of eligibility and TRQ shares between STEs and non-STE, China has created a dual allocation system for TQCs based on the end-use of the imported product. Two types of TQCs are allocated: TQC A, which is allocated for “general trade,” and TQC B, which is allocated for “processing trade” and designated for imports that are processed in China and ultimately re-exported. The subdivision of the TRQ into A and B categories appears to be a diversion from China’s accession commitment to provide import opportunities that would reflect consumer preferences and end-user demand and not inhibit quota fill.¹⁰ The subdivision essentially creates two different TRQs under the one scheduled category, which requires separate allocation based on the end-use of the product.

The processing trade subdivision is designed for products that are entering the country to serve as an input in a processed product for export. Thus, the agricultural product imported under the TRQ must be re-exported in order to qualify for the TQC B.¹¹ Counting the imports for re-export against the TRQ effectively lowers the TRQ amount by the size of the processing TRQ. In addition, the subdivision of the TRQ constrains exporters, restricting the use of the imported product relative to the domestically produced product. Splitting the TRQ by end use has implications for the fill rate, as there could be sufficient domestic demand for one category, causing the TRQ to remain binding, while the TRQ in the other category remains unfilled. It is plausible that there will be inefficient allocation between A and B (i.e., one TRQ can be over-allocated relative to the other), as it is nearly impossible for the SDPC to predict

⁷ Corresponds to paragraph 70 of the RWP.

⁸ Colby, Hunter, “*China’s Cotton Trade Under the WTO*,” Paper presented at the 2002 USDA Outlook Forum, Feb. 22, 2002.

⁹ Corresponds to paragraph 119 of the RWP.

¹⁰ Corresponds to paragraph 116 of the RWP.

¹¹ Essentially this system is analogous to the sugar re-export program administered in the United States or the inward processing relief program administered in the European Union, with one major difference, however, and that is that China is counting the imports under TQC B against the TRQ.

the actual demand for a product by end-use. Thus, the market access commitment made by China could be effectively undermined by the dual allocation system for processing and “general trade.”

To further complicate the allocation system, importers for processing trade must also apply for a separate processing business license as a precondition for application of the TQC B. Thus, if an importer wishes to import the agricultural commodity for both processing for re-export and general trade, then the importer must apply for both TQC A and TQC B. The processing business license determines the period of validity of the TQC B. Thus, it is possible that the importer of agricultural goods used in processing must apply for a business license more than once in a TRQ season (i.e., more than once in a calendar year). The business license must be obtained from the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) rather than the AA. Therefore, importers of agricultural goods for processing must first obtain the business license and then present it as verification for eligibility of application for the TQC B. Additional licensing for imports used in processing is overly burdensome and is an apparent diversion from China’s WTO commitment, for China agreed to grant access to the TRQ in a single process.¹² Also, as China does not require domestic producers to obtain a business license for purchases of domestic products used in processing, differential treatment is provided to domestically-produced products.

Non-Discrimination¹³

China has designed specific eligibility criteria for general trade applicants (i.e., for applicants of TQC A).¹⁴ The criteria have potential to restrict importers’ eligibility for TQCs in that the importer must meet certain size (and sometimes end-use) standards. For example, applicants for TQC A for wheat must meet one of the following criteria: (1) State owned enterprise; (2) Central enterprise for state reserve functions; (3) Enterprise with good import records for 2001; or (4) Enterprises with daily wheat processing over 400 MT. Non-state importers were not allowed to import prior to 2002, so that automatically forces them to meet criteria (4). If the importer cannot meet the daily processing requirement for wheat, then the importer is not eligible to receive an import license. Size criteria favor larger, state-owned enterprises that hold trading rights for TRQ commodities. In addition, for some TRQ categories, size requirements are coupled with end-use requirements (table A-4).

National Reallocation Policy for TRQs¹⁵

China has implemented a system for reallocation of unused portions of the TRQ.¹⁶ The system is based on the concept of use-it, return-it, or lose-it. An importer must return unused portions of the TRQ by September 15 of each year, or will lose the unused percentage the following year. Importers that surrender unused portions of the TRQ after September 15 are not eligible to receive reallocated portions of the TRQ. Importers must apply for reallocation to the AA between September 1-15, and the AA decides which applications to forward to the SDPC, as with the original application process for TQCs. Unused portions will be reallocated by September 30. The application for reallocation appears

¹² Corresponds to paragraph 119 of the RWP

¹³ Corresponds to paragraph 46 of the RWP.

¹⁴ See USDA, FAS, GAIN Report #CH2008, Feb. 11, 2002, for an unofficial translation of the Implementation Measures for 2002 TRQ Allocation that were issued by China on Feb. 7, 2002.

¹⁵ Corresponds to paragraph 119 of the RWP.

¹⁶ Consult Chapter Six of the Interim Rules and Regulations for Tariff Rate Quotas, USDA, FAS, GAIN Report #CH2007, Feb. 11, 2002.

burdensome in that it requires a second application on the subnational level.¹⁷ Also, the amount of time offered for the second application and approval process is extremely limited and could inhibit filling the TRQ.¹⁸ The reallocation process could be less burdensome if China allowed imports of unused portions on a FCFS basis for all those importers initially holding TQCs.

Allocation of TRQs to Non-STE¹⁹

As mentioned earlier, China agreed to allow non-state owned entities to import agricultural products that had been previously imported solely by STEs. Opening the market to nonstate enterprises is a positive step toward providing private firms an opportunity to compete for sales. On the surface, it appears that imports by private firms will be increasingly encouraged; however, even with the commitments to increase access to private traders, STEs will most likely maintain control of most sensitive agricultural commodities.

Only eleven STEs have been allocated trading rights for agricultural imports. Table A-5 provides the recognized STEs along with the product categories under which they are permitted to import. It should be noted that specific products are designated within each product category. Most of the products are subject to TRQs; however, in some cases, they are not, and the STEs dominate the right to import (e.g., one STE owns the entire right to import tobacco products and five STEs share the right to import peanut oil, sunflower seed oil, safflower seed oil, corn oil, and cotton seed oil under the vegetable oil category). Under the wheat, corn, and rice product category, durum wheat is the only type of wheat that can be imported by the STE within the TRQ.

When examining table A-5 in conjunction with table A-4, the degree to which STEs can control trade becomes apparent. For example, imports of grain (i.e., wheat, rice, and corn) are controlled by one STE: China National Cereals, Oil & Foodstuff Import and Export Company. At the close of the implementation period in 2004, the aforementioned STE will still maintain ownership of 90 percent, 60 percent, and 50 percent of the rights to import for wheat, corn, and rice, respectively. Also, one STE will be the sole owner of rights to import tobacco. While it is encouraging that private ownership of the rights to import will be allowed, STEs will still control the purchases and sales of many imported agricultural products.

National Treatment with Respect to Internal Taxation and Regulation²⁰

Imports of agricultural products are subject to a value-added tax (VAT) in China.²¹ The VAT rate for agricultural products ranges between 13 percent and 17 percent. The law pertaining to the VAT also calls for the same assessments on domestic products. However, VAT applied to imported products is

¹⁷ Consult paragraphs 116 and 119 of the RWP.

¹⁸ China agreed in paragraph 116 of the RWP that its TRQ administration process would not inhibit the filling of each TRQ.

¹⁹ See Schedule CLII, Part I, Section I-B, People's Republic of China.

²⁰ See paragraph 107 of the RWP where China agreed to administer internal taxation in full conformity with WTO obligations, which means in full conformity with GATT 1994, especially with Article III.

²¹ See Provisional Regulations on Value-Added Tax of the Peoples Republic of China. For unofficial translation consult www.china-cpa.com/Tac-Eng/Etax01.htm.

higher in absolute terms than the VAT applied to the domestic products or is applied unequally to imports and domestic products.²²

The VAT on imported products is calculated as follows: (the value of the imported product inclusive of insurance and freight (CIF value) + the import customs duty + the consumption tax) * VAT rate. Thus, not only is the imported product assessed the VAT, but insurance and freight, import tariffs, and consumption taxes are taxed as well. Therefore, the VAT for imported products is actually higher than the published VAT rate and appears to violate the WTO's national treatment principle.²³ In a recent public submission to USTR, the United States Council for International Business stated that the calculation of consumption taxes by Chinese authorities continues to discriminate against imported goods.²⁴

There are also concerns over the application of the VAT. Although all products are technically subject to the VAT, it is not clear that the tax is collected uniformly by all provinces or that all traders are actually assessed the tax. Unequal application at different ports of entry in China may create trade diversion to achieve lower assessments or no assessments. Thus, there is room for preferential treatment for certain imports that avoid the duty. Importers that are able to avoid VAT obviously obtain a cost advantage relative to other imported products. In addition, it has been reported that it is still possible for certain enterprises in China to avoid the tax for domestic goods.²⁵

VAT has often been used as a trade management tool whereby the VAT is strictly enforced to discourage imports in time of overabundance of domestic supply. For example, VAT on imported soy meal was lifted in 1995 to encourage imports and then reapplied in 1999 to reduce imports and protect the domestic oilseed crushing industry.²⁶ China is also able to use VAT as a safeguard tariff to protect the domestic industry, to be triggered only when the quantity of imports exceeds a specific level.

A final issue on the discriminatory application of VAT is exempting domestic products from the tax altogether. A recent example of this occurred for imports of corn. In January 2002, China announced its plans to maintain a 13 percent VAT on all corn imports, but exempted domestic production of corn for animal feed.²⁷

²² "China's Application of VAT on Agricultural Products," Unclassified State Department Cable (Number 705) from U.S. Embassy in Beijing to Secretary of State, Washington DC, May 9, 2002.

²³ To illustrate the double taxation that occurs for imports of agricultural goods, consider the case of exports of corn from the United States to China. The average U.S. export price for corn to China in 2001 was \$1,003 per metric ton. Adding in ocean freight, the price of U.S. corn at the Chinese border equals approximately \$1021.50 per metric ton. The in-quota import tariff on corn is 1 percent ad valorem and the over-quota tariff is 71 percent ad valorem. The VAT rate applied to corn is 13 percent. Assuming away the consumption tax on both the imported and domestic product for simplicity, the overall taxable amount in-quota is \$1031.72 per metric ton and over-quota is \$1,746.77 per metric ton. The in-quota VAT is calculated as follows: $(\$1031.72) * 0.13 = \134.12 per metric ton, which is equal to 13.4 percent of the border price. The over-quota VAT is calculated as follows: $(\$1,746.77) * 0.13 = \227.08 , which is 22.2 percent of the border price. As the value of the import tariff increases, the VAT increases. Thus, the published VAT of 13 percent is not the actual rate that is applied to U.S. imports of corn.

²⁴ United States Council for International Business, Public Comments to USTR Concerning China's Compliance with WTO Commitments, Sept. 10, 2002, p. 3.

²⁵ USDA, ERS, Briefing Room: China Policy, www.ers.usda.gov/briefing/china/tradepolicy.htm, accessed on Nov. 27, 2001.

²⁶ USDA, ERS, Briefing Room: China Policy, www.ers.usda.gov/briefing/china/tradepolicy.htm, accessed on Nov. 27, 2001.

²⁷ "China's Application of VAT on Corn Violates WTO's National Treatment Principle," Unclassified State Department Cable (Number 452) from U.S. Embassy in Beijing to Secretary of State, Washington DC, Jan. 18, 2002.

DOMESTIC REGULATIONS IMPACTING AGRICULTURAL IMPORTS

The rules that U.S. exporters face are still evolving as China struggles to adapt its old bureaucratic structures to a new, broader legal system based on the “rule of law”.²⁸ This section of the paper looks at six areas of Chinese domestic regulations: Genetically-modified organisms (GMOs); product standards, testing, (non-GMO) labeling, and certification; retailing and direct selling; transportation and distribution; foreign investment; and anti-competitive practices.

Genetically-Modified Organisms (GMOs)

English-language regulations on GMO farm products were released by China in January and took effect on March 20, 2002. According to U.S. Government officials and industry analysts, the regulations are written vaguely and could force food importers to navigate a difficult regulatory process.²⁹ The GMO regulations can be divided into two sections: (i) Measures on GMO Labeling and (ii) Measures on GMO Safety Evaluation.

Measures on GMO Labeling

Rules for labeling GMO products in China are regulated by MOA and were designed to apply to both domestically-produced and imported biotech foods and animal feeds, including processed derivatives such as soybean meal and oil. Although China’s Ministry of Agriculture recently stated that foreign exporters do not have to apply for GMO labels for their bioengineered products, it is not yet clear whether the relaxing of GMO labeling rules for imports is permanent or merely a temporary measure.³⁰ The first list of GMOs falling under the Chinese labeling system include: (i) Soybean seed for planting, soybeans, soybean flour, soybean oil, and soybean meal; (ii) Corn seeds for planting, corn, corn oil, and corn flour (including corn flour under HS codes 11022000, 11011300, and 11042300); (iii) Rape seed for planting, rape seed, rape oil, and rape meal; (iv) Cotton seed for planting; (v) Tomato seed for planting, fresh tomatoes, and tomato sauce. Other lists of products requiring labels are likely to follow.³¹

The Chinese labeling regulations do not specify a tolerance level (the percentage of the product containing GMOs) under which labeling would not be required. Therefore, if applied to imports, these regulations effectively establish a zero-tolerance limit, similar to restrictive standards imposed by South Korea and the European Union.³² Because U.S. producers use GMO seed varieties to produce many crops in the United States (for example, 68 percent of harvested soybean acreage and more than 80 percent of cotton acreage in 2001), these standards will certainly raise the cost of sending U.S. agricultural products to China.³³ Distribution channels of GMO and non-GMO products may need to be separated in order to

²⁸ “Rule of law” can best be described here as adherence to due process under the law rather than favoritism, nepotism, corruption, or rule by fiat. See Goldstein, Brian L., and Stephen J. Anderson, “Foreign Contributions to China’s WTO Capacity Building,” *The China Business Review*, January-February 2002, p. 15.

²⁹ Elliott, Ian, “China’s new GMO regulations could hurt U.S. soybean industry,” *Feedstuffs*, Mar. 11, 2002, p. 2.

³⁰ See “China Clarifies New Rules on Genetically Modified Foods,” *The Wall Street Journal*, Mar. 29, 2002, p. A10.

³¹ Gifford, Ralph, et al., “Food and Agricultural Import Regulations and Standards, Ag GMO Implementation Measures, 2002” USDA, FAS, GAIN Report #CH2002, U.S. Embassy, Beijing, Jan. 14, 2002, p. 16.

³² Ash, Mark and Erik Dohlman, “New Biotech Labeling Rules to Delay China Imports,” *Oil Crops Outlook*, USDA, ERS, Feb. 11, 2002, p. 3.

³³ Ash, Mark and Erik Dohlman, “New Biotech Labeling Rules to Delay China Imports,” *Oil Crops Outlook*, USDA, ERS, Feb. 11, 2002, p. 3, and *Prospective Plantings*, NASS, USDA, Mar. 28, 2002.

maintain identity-preservation. As late as March 20, 2002, the day that the GMO regulations went into effect, China was still issuing supplementary rules, forcing foreign companies to re-submit applications for labeling imports. At that time, no permits had been issued for foreign firms to import GMO food.³⁴

Measures on GMO Safety Evaluation

The Chinese Government has also published regulations for evaluating the safety of GMO products. These rules are designed to safeguard the health of humans and the safety of animals, plants, and microorganisms, as well as protect the environment: GMO research, testing, processing, marketing, and imports/exports of agricultural products are all subject to regulation.³⁵ Beginning March 20, all foreign shipments of biotech food or animal feed must apply for a safety certificate from China's Ministry of Agriculture (MOA). The certificate must include a government statement from the originating country that it poses no harm to humans, animals, or the environment. As the regulations currently read, MOA will carry out safety evaluations of GMOs in agricultural products twice a year, with applications due March 31 and September 30.³⁶ MOA will accept or reject applications within 2 months after receiving them and make decisions on accepted applications within 3 months of the application deadline. In addition to approval at the national level, companies must obtain approval for conducting experiments and approval for using the safety certificate from the provincial agricultural administrative department.³⁷

Although the new regulations are somewhat vague, it is clear that the Chinese government has created a detailed and complex documentation and approval system under which U.S. agricultural GMOs will be evaluated. At least in the initial stages, the regime will require U.S. exporters to ensure that their products are properly classified, tested, and ultimately approved by the requisite governmental agency. This will require paperwork at several different stages of the process, including applications, inspection reports, and summary reports of prior experiments on the product. A close working relationship with Chinese partners familiar with the both national and provincial bureaucracies will be essential.³⁸

³⁴ Yee, Lee Chyen, "China drags feet on GMO certificates, markets fret," Mar. 20, 2002, found at biz.yahoo.com, downloaded Apr. 1, 2002.

³⁵ Gifford, Ralph, et al., "Food and Agricultural Import Regulations and Standards, Ag GMO Implementation Measures, 2002" USDA, FAS, GAIN Report #CH2002, U.S. Embassy, Beijing, Jan. 14, 2002, p. 1.

³⁶ China can halt shipments of U.S. agricultural imports containing GMOs for as long as 270 days during the approval process. U.S. exporters would not be allowed to sign sales contracts until safety certificates are obtained from the MOA. To complicate matters, MOA will require different combinations of documents for GMO imports used for research, environmental release, production, or raw materials, and would place all products into one of four categories: those posing no danger, and those with low, medium, or high degree of danger. The quarantine process for GMO imports at Chinese ports, implemented by the Chinese central quarantine agency in October 2001, involves two inspections and can take up to two weeks after goods arrive in port. See Industry Letter to President Bush on China Biotech Rules, signed by various U.S. Industry Groups, Oct. 2, 2001, as reprinted in *Inside U.S. Trade*, Oct. 5, 2001.

³⁷ Gifford, Ralph, et al., "Food and Agricultural Import Regulations and Standards, Ag GMO Implementation Measures, 2002" USDA, FAS, GAIN Report #CH2002, U.S. Embassy, Beijing, Jan. 14, 2002, p. 6.

³⁸ Companies testing GMOs of U.S. agricultural products in China must have a specialized technical institution in China, have full-time technical staff testing and researching GMO products, have suitable equipment and facilities for such research, and establish an agriculture GMO safety administration group to examine application materials that must be submitted for approval. Experimental summary reports, production plans, and progress reports must be regularly submitted to the MOA and the local agricultural administrative department. See Gifford, Ralph, et al., "Food and Agricultural Import Regulations and Standards, Ag GMO Implementation Measures, 2002" USDA, FAS, GAIN Report #CH2002, U.S. Embassy, Beijing, Jan. 14, 2002, p. 6.

Officials at China's Ministry of Agriculture have recently stated that foreign exporters will not need to apply for separate safety certificates for each shipment of the product, as previously indicated. Instead, one set of safety certificates can apply for all shipments of the same type of GMO product shipped by the same exporters to the same buyers. This has increased the hopes of U.S. exporters (particularly soybean producers)³⁹ that safety certificates could be obtained from Chinese officials one month after the initial applications are submitted.⁴⁰ But, China has yet to provide instructions for companies wishing to comply with current biotech food safety and labeling regulations.⁴¹ Central Soya Company, a leading U.S. processor and exporter of soybean products, recently stated in a public submission to USTR that significant trade disruptions of U.S. exports of soybean products to China still exist due to a lack of transparency on the part of Chinese officials regarding safety certification and labeling regulations.⁴²

Product Standards, Testing, (Non-GMO) Labeling, and Certification

China has recently started to reform its standards, labeling, and certification regulations. In September 2001, Beijing merged the domestic and quarantine testing agency into one regulatory body called the State General Administration for Quality Supervision and Inspection and Quarantine (AQSIQ). The plan is that AQSIQ will administer China's product quality regulations, including testing and enforcement. Beijing has also created two testing organizations to certify products, set technical standards, and unify testing procedures. Modeled on the Underwriters' Laboratory,⁴³ these groups should help eliminate double testing and multiple fees for imports.⁴⁴

One product area that may ultimately benefit from the recent reforms in standards and certification is organic goods. Standards for "organic" or "green" foods are becoming increasingly more important for Chinese consumers as they become more affluent and aware of how different types of food

³⁹ One example of the difficulties facing U.S. exporters involves entry delays of foreign soybeans and processed soybean products through Chinese ports. The continued uncertainty of the new regulations has disrupted trade even if the end result of the new Chinese laws is not substantively different from the old regime. USDA has reduced its forecast of China's soybean imports from the United States during marketing year 2001/02 from 14.0 million MT to 13.5 million. Prospects for soybean meal imports were also cut to 200,000 MT. In the short term, Chinese soybean prices should rise and encourage more planting in China next spring. See Ash, Mark and Erik Dohlman, "New Biotech Labeling Rules to Delay China Imports," *Oil Crops Outlook*, USDA, ERS, Feb. 11, 2002.

⁴⁰ "China Clarifies New Rules on Genetically Modified Foods," *The Wall Street Journal*, Mar. 29, 2002, p. A10.

⁴¹ Willard A. Workman, Senior VP for International Affairs, U.S. Chamber of Commerce, Statement before USTR, Sept. 18, 2002, p. 3.

⁴² Central Soya Company, Inc., Public Comments to USTR Concerning China's Compliance with WTO Commitments, Sept. 10, 2002, p. 2.

⁴³ Underwriters Laboratories Inc. is a U.S. non-profit organization that evaluates the safety of products, materials, and systems.

⁴⁴ 2002 National Trade Estimate Report of Foreign Trade Barriers, USTR, p. 53.

are produced. Both MOA⁴⁵ and the State Environmental Protection Agency (SEPA)⁴⁶ have promulgated standards in recent years. Each agency publishes guidelines for testing and certifying organic foods so that consumers are aware of product differences in the marketplace. Unfortunately, neither standard has yet to gain nationwide acceptance and each focuses on different priorities.⁴⁷ Without a unified set of domestic standards, Chinese consumers are likely to be confused about what “organic” certification means and may be unwilling to pay a price premium for organic foods.

The impact these regulations will have on imports of U.S. organic food into China is still unclear. Because dueling domestic standards create confusion in the minds of Chinese consumers, convincing them to pay more for U.S. organic foods may be difficult.

Retailing and Direct Selling

In 1999, China expanded opportunities for foreign investment in the retail sector. The 1999 regulations permitted large foreign retailers like Wal-Mart and Carrefour to build outlets. China’s WTO commitments further expand the ability of foreign retailers, including wholly-owned foreign franchises in many sectors within three years of accession. Normally, the establishment of foreign-owned retailers in previously closed markets promotes products sourced from many different countries. However, imported foods still account for less than 5 percent of food stocks within supermarkets because most well-known branded products are manufactured locally under license or in joint-venture operations.⁴⁸

Selling imported products directly to consumers (either through telemarketing, catalogs or the Internet) continues to be difficult for U.S. companies. As recently as 1998, China made all direct selling illegal because some Chinese consumers were losing money to fraudulent schemes perpetuated by both foreign and Chinese firms using direct selling techniques.⁴⁹ Under their WTO Accession agreement, the Chinese Government has agreed to permit all legitimate direct selling activities within 3 years of

⁴⁵ MOA developed the “Green Food” standard in 1992, dividing qualifying foods into “A” and “AA” categories. Both designations rate the environmental quality of the region on which the food is produced, setting minimum standards for air, water, and soil contaminants. The A standard is less demanding and is designed for domestic consumers that want safer food but not at a price premium. For example, pesticide use under the A standard does not ban all pesticides use, but instead regulates the amount and timing of use. The AA standard is closer to U.S. and European concepts of “organic food,” and bans the use of any synthetic pesticides, hormones, or veterinary medicines. Only simple chemical fertilizers are permitted. The additional cost in producing AA products will limit the demand for these goods in Chinese markets, however. See Bean, Ralph, et al., “Organic Products, Dueling Standards for Organic Foods, 2001” USDA, FAS, GAIN Report #CH1072, U.S. Embassy, Beijing, Dec. 12, 2001.

⁴⁶ SEPA issued regulations on its “Organic Standard” in July 2001. While some of the technical details for the new standards remain unresolved, SEPA’s organic standard bans the use of pesticides, chemical fertilizers, hormones, chemical additives, and genetic engineering technology. Applicants must undergo a detailed certification process, with renewal every two years. See Bean, Ralph, et al., “Organic Products, Dueling Standards for Organic Foods, 2001” USDA, FAS, GAIN Report #CH1072, U.S. Embassy, Beijing, Dec. 12, 2001.

⁴⁷ See Bean, Ralph, et al., “Organic Products, Dueling Standards for Organic Foods, 2001” USDA, FAS, GAIN Report #CH1072, U.S. Embassy, Beijing, Dec. 12, 2001.

⁴⁸ Moustakerski, Peter, and La Verne E. Brabant, “Peoples Republic of China, Retail Food Sector Report, 2001,” USDA, FAS, GAIN Report #CH1810, U.S. Embassy, Beijing, Nov. 2, 2001, p. 5.

⁴⁹ 2002 National Trade Estimate Report of Foreign Trade Barriers, USTR, p. 63.

accession.⁵⁰ But China recently issued regulations further restricting sales made away from a fixed location, and contrary to its WTO obligations, did not consult companies regulated under the new rules.⁵¹

Transportation and Distribution

Importing, transporting, and distributing U.S. foods in China remains difficult because the illegal smuggling channels through Hong Kong that traditionally supplied Chinese consumers are being squeezed out by government officials in Beijing.⁵² This development has forced foreign exporters to invest additional time and money creating legitimate trading channels in mainland ports such as Shanghai, Dalian, Qingdao, and Tianjin. In order to coordinate Chinese laws and regulations in line with WTO commitments, new laws and standards are being created that are designed to tighten compliance and develop “rules-based” regimes. But in the short run, local importers and foreign exporters claim that they only add to the confusion and increase their costs.⁵³

China’s transportation and distribution sectors face a multitude of factors that impact U.S. trade in agricultural products, including stringent regulatory standards, high costs (in part due to poor infrastructure), domination by government-owned entities, severe limitations on permissible activities, and a convoluted regulatory regime with several government agencies competing for overlapping legal jurisdictions. The agencies involved include the State Domestic Trade Bureau, the Ministry of Communications, the Ministry of Railways, the Ministry of Foreign Trade and Economic Cooperation, the State Economic and Trade Commission, the State Development Planning Commission, and the Civil Aviation Administration. In addition to overlapping jurisdictions, these agencies also set complex approval requirements. Another issue that U.S. exporters will need to address is that although the Chinese Postal Bureau is inefficient and slow, the bureau is attempting to maintain its legal monopoly over the delivery of small packages and urgent letters throughout the country.⁵⁴

China’s WTO accession agreements set in motion a range of reforms designed to open up the Chinese transportation sector to foreign companies within six years. After that time, U.S. firms will be able to invest in road and rail freight transport and freight forwarding companies. China has not yet issued implementation rules and sector regulations.⁵⁵ Foreign-ownership of distribution and marketing networks in bulk commodities such as cotton will be permitted within 3 years of accession.⁵⁶

Foreign Investment Regulations and Restrictions

China has maintained investment barriers to protect domestic industries and local jobs, protect national security (as defined by the leadership), and limit imports perceived to be luxury goods or harmful to the balance of trade. Under the terms of its accession to the WTO’s Trade-Related Investment

⁵⁰ Ibid.

⁵¹ Willard A. Workman, Senior VP for International Affairs, U.S. Chamber of Commerce, Statement before USTR, Sept. 18, 2002, p. 4.

⁵² Moustakerski, Peter, and La Verne E. Brabant, “Peoples Republic of China, Retail Food Sector Report, 2001,” USDA, FAS, GAIN Report #CH1810, U.S. Embassy, Beijing, Nov. 2, 2001, p. 7.

⁵³ Moustakerski, Peter, and La Verne E. Brabant, “Peoples Republic of China, Retail Food Sector Report, 2001,” USDA, FAS, GAIN Report #CH1810, U.S. Embassy, Beijing, Nov. 2, 2001, p. 7.

⁵⁴ 2002 National Trade Estimate Report of Foreign Trade Barriers, USTR, p. 64.

⁵⁵ Ibid.

⁵⁶ Colby, Hunter, “China’s Cotton Trade Under the WTO,” Paper presented at the 2002 USDA Outlook Forum, Feb. 22, 2002.

Measures (TRIMs) agreement, China will liberalize these restrictions in stages and has already eliminated export performance and local content requirements for foreign investors. But U.S. officials are concerned that Beijing is prepared to unofficially re-impose local content requirements on U.S. companies in exchange for favoritism by government officials, both at the national and local levels. It should be noted that Chinese officials have negotiated similar “under the table” agreements in the past to obtain technology transfers from foreign companies.⁵⁷

Foreign investors continued to invest in China, to the tune of \$46.9 billion in foreign direct investment (FDI) in 2001.⁵⁸ Although China’s leadership in Beijing is committed to encouraging FDI, barriers persist, including non-transparent and inconsistently enforced laws. Foreign investment regulations continue to be micro-managed by Chinese Government officials at all levels. Continual revisions to investment rules over the past five years have confused investors and discouraged certain investments. In many sectors, foreign companies must form a joint venture with a Chinese company and maintain only a minority share in the entity.⁵⁹ In October 2000, Beijing amended three laws affecting joint ventures, wholly-owned firms, and foreign direct investment. The changes eliminated export performance requirements, revised “Buy China” policies, and ended requirements that companies submit production and operation plans to government officials. Implementing regulations for these new laws were issued in April and July 2001.⁶⁰

In July 2001, SETC approved the first foreign investment of a wholesaler in China. The Shanghai No. 1 Department Store Group opened a wholesale joint venture with Japan’s Marubeni Co. Marubeni Co. received a 49 percent share of the venture. The new company can purchase and sell domestic products nationwide and import and export foreign goods.⁶¹ As of the end of 2001, this was the only wholesale foreign investment enterprise (FIE) approved by Beijing. Thirty-two *retail* FIEs have been officially approved, and 216 retail FIEs have been illegally approved by local and provincial governments. These locally-approved retail FIEs have been ordered by Beijing to restructure or disband, but compliance is spotty.⁶² Foreign ownership rights in many areas of the Chinese economy continue to expand, albeit slowly and not uniformly across sectors. Over the next 3 years, the Chinese Government has agreed to expand foreign ownership rights even further. Unfortunately, only after the WTO accession agreements have been fully implemented will it be known to what extent new investment opportunities exist for U.S. companies.

Anti-Competitive Practices

Any discussion of foreign investment and U.S. trade in China would be incomplete without a brief discussion of anti-competitive practices. Protectionism at the local and provincial levels, predatory pricing, and national protection of domestic monopolies continue in Chinese markets. Anti-competitive practices take many forms, including price fixing, contract allocation, and provincial transportation

⁵⁷ 2002 National Trade Estimate Report of Foreign Trade Barriers, USTR, p. 68.

⁵⁸ *Ibid.*, p. 67.

⁵⁹ In August 1999, China began to decentralize investment approval decision-making, allowing provincial authorities to approve certain projects and raised the investment value beyond which central government approval is required. China’s State Economic and Trade Commission (SETC) have announced that further liberalization will be announced in 2002.

⁶⁰ 2002 National Trade Estimate Report of Foreign Trade Barriers, USTR, p. 67.

⁶¹ Waterman, Jeremie, “Toward WTO: Highlights of PRC Implementation Efforts to Date, September 2001,” *The China Business Review*, January-February 2002, p. 14.

⁶² Zeng, Xianwu, “Trading Rights After China’s WTO Entry,” *The China Business Review*, January-February 2002, pp. 16-20.

restrictions which reduce competition between domestic and foreign goods. China is in the process of drafting new anti-trust laws because current laws are ineffective due to poor national coordination and inconsistent local and provincial enforcement.⁶³

U.S. COMPETITIVENESS IN THE CHINESE MARKET VIS-À-VIS ITS MAJOR INTERNATIONAL COMPETITORS

Even with full implementation of the WTO market access commitments and compliance with Chinese domestic regulations, U.S. exporters still face the hurdle of competition from other exporting countries. China chooses its import suppliers largely on the basis of price and therefore the U.S. competitiveness in the Chinese market vis-à-vis other exporting countries is critical. In general, production costs are the most important factor affecting conditions of competition between foreign and U.S.-produced products, which are heavily influenced by natural resource endowment, production and processing technology, as well as labor costs. Another factor determining competitiveness is proximity to the Chinese market, which determines transportation costs. U.S. competitiveness also depends on the strength of the dollar vis-à-vis the currencies of its major international competitors. These factors indicate that the United States will face additional competition in many Chinese agricultural product markets.

Wheat

China is the largest wheat producing and consuming country in the world.⁶⁴ Historically, China has also been a major wheat purchaser. However, imports were under strict government control and fluctuated according to domestic supply and demand conditions.⁶⁵ During the early 1990s, China was a major importer of wheat, with imports averaging more than 9 million MT annually between 1990/91 and 1994/95 (and as high as 16 million MT in 1991/92) to meet domestic consumption requirements. In 1995, the “Governor’s Grain Bag” program was introduced, aimed at reducing import dependence by providing price incentives to boost domestic production.⁶⁶ Higher procurement prices coupled with favorable weather conditions resulted in a significant expansion in production—increasing from 103 million MT in 1995/96 to over 123 million MT in 1997/98. At the same time, consumption growth continued to stagnate owing largely to increased consumer demand for higher-valued food items (such as meat, fruits, and vegetables).⁶⁷ As domestic prices fell to procurement level, government purchases resulted in substantial stocks, which increased to over 70 million MT in 1997/98. Imports were cut dramatically, dropping from 12.5 million MT in 1995/96 to less than 1 million MT in 1997/98. Since 1999, in an effort to reduce stocks and to prepare for additional imports under WTO accession, China reduced support prices and is no longer procuring wheat of low quality.⁶⁸ As a result, production over the last 3 years has dropped significantly (to only 94 million MT in 2001/02) with land being placed in more profitable crops (such as

⁶³ 2002 National Trade Estimate Report of Foreign Trade Barriers, USTR, p. 69.

⁶⁴ During 1998-2000, China accounted for about 18 percent of world production and almost 20 percent of world consumption. USDA, FAS, *Grain: World Markets and Trade*, Circular series FG12-01, Dec. 2001.

⁶⁵ USDA, ERS, “State Trading and Management of Grain Marketing in China,” *Agricultural Outlook*, June-July 1999, pp. 27-30.

⁶⁶ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, November 2001, p. 17.

⁶⁷ USDA, ERS, *Briefing room. China: trade*, Dec. 27, 2000, at <http://www.ers.usda.gov/briefing/china/trade.htm>, retrieved Oct. 17, 2001.

⁶⁸ USDA, FAS, *China Grain and Feed. Annual 2001*, GAIN Report #CH1007, Mar. 19, 2001.

rapeseed, cotton, fruits, and vegetables). Wheat stocks reached levels existing in the early 1990s, and Chinese imports have continued to remain at very low levels.

Although China established wheat quality standards in April 2000 in an effort to encourage domestic production of high-quality wheat,⁶⁹ millers continue to complain about the poor quality and lack of uniformity of domestically produced wheat (mainly middle protein varieties),⁷⁰ which is typically blended with high-quality imports depending on the end use.⁷¹ For example, bread makers require high-protein, high-gluten wheat, such as imported Dark Northern Spring, Soft Red Winter, and Hard Red Spring.⁷² Imported low protein wheat, such as Western White, is used by manufacturers of noodles, cakes, and cookies. Thus imports have established a niche among Chinese millers and food manufacturers, which will play a key role in future trends.

China's wheat imports have been almost exclusively supplied by three countries—Canada, the United States, and Australia (table A-6). With the exception of 1999, Canada has been the major supplier, with an import share of about 60-70 percent since 1997. The United States typically supplies 20-30 percent, and Australia the remainder. Canada and Australia are highly competitive with the United States in the Chinese market. Both countries have substantial advantages over U.S. wheat in terms of favorable freight rates and exchange rates vis-à-vis the U.S. dollar. Canada and Australia also trade wheat through STEs which provide bargaining power in transacting with the Chinese, and until 1999, the United States faced a ban on wheat from the U.S. Pacific Northwest (PNW) imposed following the presence of TCK spores in shipments from the region.⁷³ The United States and Australia have an advantage over Canada in supplying low protein, Soft White wheat, which is not produced extensively in Canada.

As mentioned earlier, China has committed to establish a TRQ for wheat of 8.5 million MT in 2002, increasing to 9.6 million MT by 2005. If this quota level were reached, imports would account for about 8 percent of domestic use. Some analysts do not expect the quota level to be reached. Koo, for example, estimated Chinese imports to reach 3.4 million MT by 2005 under a scenario close to China's WTO commitment.⁷⁴ The analysis indicated that U.S. exports to China would reach 1.6 million MT (of which 0.7 million MT would be diverted from other markets). Fuller *et al.* also forecast Chinese imports below the TRQ level at between 5 million MT and 7 million MT annually over the next 10 years.⁷⁵ The USDA recently predicted China's wheat imports to expand by 2.6 million MT annually as a result of WTO accession.⁷⁶ Based on factors of competition and recognizing the removal of the ban on product from the PNW, China's WTO accession could result in the United States supplying between 35 percent

⁶⁹ USDA, FAS, *China Grain and Feed. Annual 2002*, GAIN Report #CH2010, Mar. 4, 2002.

⁷⁰ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, pp. 17.

⁷¹ USDA, FAS, *China Grain and Feed. Annual 2001*, GAIN Report #CH1007, Mar. 19, 2001.

⁷² USDA, FAS, *China Grain and Feed. Annual 2002*, GAIN Report #CH2010, Mar. 4, 2002.

⁷³ Concern over TCK smut resulted in a ban on imports of wheat and other grains from 7 Pacific Northwest states. This ban was dropped under the U.S./China agricultural cooperation agreement of April 1999. Source: U.S.-China Agricultural Cooperation Agreement. Removal of Sanitary/Phytosanitary Barriers to U.S. Exports, Fact sheet, Feb. 15, 2000, at <http://www.mac.doc.gov/China/Docs/agriculturefactsheets/agriculturebilat.htm>, retrieved Mar. 20, 2002.

⁷⁴ Koo, W.W. "The Impact of China's Accession into the WTO on the U.S. Wheat Industry," Agricultural Economics Report No. 440, Northern Plains Trade Research Center, Fargo, ND, June 2000.

⁷⁵ Fuller, F., J. Beghin, S. De Cara, J. Fabiosa, C. Fang, and H. Matthey, *China's Accession to the WTO: What is at Stake for Agricultural Markets*, Center for Agricultural and Rural Development, Working Paper 01-WP 276, June 2001.

⁷⁶ Conklin, N., "China's Accession to WTO: Implications for U.S. Agricultural Exports," USDA, ERS, presented at Agricultural Outlook Forum 2002, Feb. 22, 2002.

and 50 percent of China's wheat import needs. This would be the equivalent of about 1.5 million MT to 3.5 million MT, annually.

Rice

China accounts for about one-third of the world's rice production and consumption.⁷⁷ During 1997-2001, annual rice consumption remained stable at about 134 million MT,⁷⁸ while production fell from about 140 million MT in 1997 to 127 million MT in 2001, in response to greater returns from producing other crops⁷⁹ and the termination of government purchases in southern China in 2000.⁸⁰ China imports and exports small volumes of rice, with net exports averaging about 2.3 million MT annually during 1997-2001.

Chinese rice exports consist of primarily lower-grade short-grain japonica rice, produced in the northern provinces and shipped to several markets, including neighboring Asian markets, Côte d'Ivoire, Iraq, and Cuba. Imports consist principally of long-grain indica rice.⁸¹ Almost all Chinese rice imports come from Thailand (the world's largest rice exporting country), consisting of high-quality fragrant varieties of rice (mainly jasmine rice) that are sold to high-income urban consumers.⁸² The United States is the second largest supplier, although imports amounted to only about 500 tons annually over the past five years (table A-7).

Several competitive factors favor Thai rice in the Chinese market. Thailand's costs of production are lower than most other countries (with the exception of Vietnam) and enjoys very low transportation costs to China, especially rice entering southern China. Further, imports of high-quality jasmine rice are increasingly demanded which is produced mainly in Thailand and Vietnam. Fragrant rice varieties are not extensively produced by the United States. U.S. exports also face high transportation costs to China.

The Chinese rice TRQ which will expand to 5.3 million MT annually by 2005, representing more than one-third of current world trade. USDA analysts report that by 2005 China's imports could represent 20-30 percent of world trade, resulting in higher world rice prices, especially prices of specialty rices.⁸³ However, analysts do not expect significant changes in U.S./China rice trade as a result of WTO accession since existing competitive factors that favor U.S. competitors (mainly Thailand and Vietnam) likely will continue.⁸⁴

⁷⁷ USDA, FAS, *Grain: World Markets and Trade*, Circular series FG12-01, December 2001.

⁷⁸ Per capita rice consumption has declined in recent years as higher-valued products, such as fresh fruit, vegetables, and meat, substituted for rice in the Chinese diet. Today rice is considered an inferior product in China.

⁷⁹ USDA, ERS, *Briefing room. China: Outlook*, Dec. 28, 2000, at <http://www.ers.usda.gov/briefing/china/outlook.htm>, retrieved Oct. 17, 2001.

⁸⁰ USDA, FAS, *China Grain and Feed Annual 2001*, GAIN Report #CH1007, Mar. 19, 2001.

⁸¹ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, p. 28.

⁸² USDA, FAS, *China Grain and Feed. Annual 2002*, GAIN Report #CH2010, Mar. 4, 2002.

⁸³ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, p. 29.

⁸⁴ Conklin, N, "China's Accession to WTO: Implications for U.S. Agricultural Exports," USDA, ERS, presented at Agricultural Outlook Forum 2002, Feb. 22, 2002.

Corn

China is the second leading corn producing and consuming country in the world (behind the United States).⁸⁵ China is also among the world's top corn exporting countries. During the late 1990s, China's corn production rose sharply in response to favorable government procurement prices that were kept above world price levels, resulting in government stocks filled to capacity⁸⁶ (estimated at more than 100 million MT, about 60 percent of world corn stocks) and increased exports supported by large export subsidies.⁸⁷ China's corn imports, which up until WTO accession were exclusively controlled by the government, have been negligible in recent years (only 307 MT were imported in 2000). This compares to the mid-1990s, when China imported close to 6 million MT.

When China imported significant volumes of corn, the United States was the major supplier (typically with 70 percent or more import share).⁸⁸ The United States competes with the EU, Argentina, and more recently, Indonesia and Thailand (table A-8). The United States is highly competitive in world markets, owing to low production costs and highly efficient distribution and transportation networks. Potentially, Argentina will be a highly competitive exporter for corn to China (particularly in the off-U.S. season, March till August), owing to price advantages associated with a devalued Argentine peso. Thailand and Indonesia also benefit from close proximity to southern China where most corn imports are consumed.⁸⁹

Expected increased demand for animal feed should bolster Chinese demand for corn in the future. The USDA predicts that China will become a net importer of corn over the next ten years, although imports likely will be below the TRQ level of 7.2 million MT by 2005.⁹⁰ As mentioned above, TRQ administration and regulations governing GMOs will play a crucial role in determining U.S. corn exports.⁹¹ Another potential benefit to U.S. exporters involves China's commitment to eliminate export subsidies on corn. This may provide opportunities to U.S. exporters in markets currently served by China.⁹² In the short term, though, U.S. corn exporters are concerned that China has allocated its corn TRQs in ways that hinder potential corn imports, even under favorable market conditions. The U.S. Grain Council recently submitted public comments to USTR stating that China's regional allocation of corn TRQs gave overweighted access to regions such as Jilin and Heilongjiang while limiting quota

⁸⁵ USDA, FAS, *Grain: World Markets and Trade*, Circular series FG12-01, Dec. 2001.

⁸⁶ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, p. 13.

⁸⁷ Annual export corn subsidies have exceeded \$1 billion in recent years. USDA, FAS, *China Grain and Feed Annual 2002*, GAIN Report #CH2010, Mar. 4, 2002, p. 8. Although China was to abolish its export subsidies for corn upon WTO entry in December 2001, it continues to sell corn below world prices into large feed grain markets South Korea and Malaysia. National Barley Growers Association, "Comments on WTO Agricultural Negotiations," May 1, 2002, p. 1.

⁸⁸ The United States is by far the largest corn exporting country in the world, accounting for about 70 percent of world exports in recent years. USDA, FAS, *Grain: World Markets and Trade*, Circular series FG12-01, December 2001.

⁸⁹ Most Chinese corn is grown in the northeast provinces and North China Plain, and is either consumed in the north or exported to East and Southeast Asia (e.g., South Korea, Malaysia, Indonesia, and Japan). USDA, ERS, *Briefing room. China: Outlook*, Dec. 28, 2000, at <http://www.ers.usda.gov/briefing/china/outlook.htm>, retrieved Oct. 17, 2001.

⁹⁰ USDA, ERS, "WTO Accession Will Increase China's Agricultural Imports," *Agricultural Outlook*, April 2002.

⁹¹ USDA, FAS, *China Grain and Feed Annual 2002*, GAIN Report #CH2010, Mar. 4, 2002.

⁹² Conklin, N., "China's Accession to WTO: Implications for U.S. Agricultural Exports," USDA, ERS, presented at Agricultural Outlook Forum 2002, Feb. 22, 2002.

access to traditional purchasers of corn imports in Guangdong.⁹³ In addition, quantities allocated to Chinese companies averaged 6,600 MT, a volume far too small to be shipped economically. The U.S. Grain Council stated that these allocations raise shipping costs and act as a barrier to trade.⁹⁴

Soybeans and Soybean Products

During the 1990s, Chinese government policy has significantly impacted trends in production and trade of soybeans and soybean products (soybean oil⁹⁵ and soybean meal⁹⁶).⁹⁷ In an effort to boost domestic production of animal feed for the growing livestock sector, the Chinese Government lifted the VAT⁹⁸ on imported soybean meal in 1995,⁹⁹ which resulted in a significant increase in imports of soybean meal. Consequently, soybeans and soybean oil production declined as margins in the oilseed crushing industry declined. The shortage of soybean oil resulting from less domestic crushing led to an influx of unofficial imports. To redress the imbalance, the VAT was reinstated in July 1999 giving a huge incentive to increase imports of soybeans, and between 1998 and 2001 a nearly four-fold increase in imports of soybeans pushed China to the world's second leading import market (behind only the EU). At the same time, imports of soybean meal dropped significantly—from almost \$1 billion in 1997 to almost nothing in 2001.

The United States is the leading world soybean exporter to China (with an import share of about 50 percent) and doubled the value of its exports between 1999 and 2001 to more than \$1 billion (table A-9). Argentina and Brazil are the other major suppliers to China (each with a share of about one-quarter). Chinese imports of soybean oil fell from about 1.2 million MT in 1997 to only 70,000 MT in 2001, with imports from the United States dropping to just 11,000 MT in 2001, compared with almost 400,000 MT in 1998 (table A-10). The United States supplies about 10 percent of China's soybean oil imports; Argentina, about 70 percent, and Brazil most of the remainder. Major suppliers of soybean meal to the Chinese market during the late 1990s were Argentina, India, and Brazil (table A-11).

The United States competes with Argentina and Brazil for sales of soybeans and soybean products, particularly during the off season to the U.S. harvest (March through August). Like the United States, Argentina and Brazil are highly efficient producers of soybeans, and state-of-the-art crushing facilities make these countries highly competitive in the production of soybean products. The strong U.S. dollar and the devalued Argentine peso disadvantage U.S. soybean exports. Chinese regulations on GMO soybeans potentially could put the United States at a competitive disadvantage against Argentina and Brazil.

⁹³ U.S. Grains Council, Public Comments to USTR Concerning China's Compliance with WTO Commitments, Sept. 10, 2002, p. 1.

⁹⁴ U.S. Grains Council, Public Comments to USTR Concerning China's Compliance with WTO Commitments, Sept. 10, 2002, p. 2.

⁹⁵ Chinese consumption of vegetable oils has risen steadily as consumers have turned to using more cooking and salad oils in their diets, sustained by higher incomes.

⁹⁶ Chinese consumption of protein meals rose by nearly 30 percent over the past four years as strong demand for pork and poultry boosted animal feed demand.

⁹⁷ USDA, ERS, *Briefing room. China: Outlook*, Dec. 28, 2000, at <http://www.ers.usda.gov/briefing/china/outlook.htm>, retrieved Oct. 17, 2001.

⁹⁸ The VAT on soybean meal imports provided an incentive to the domestic crushing industry and led to a rapid rise in imports of unprocessed soybeans and thus boosted domestic production of soybean oil and meal. USDA, FAS, *China PRC Oilseeds and Products Annual (part II) 2001*, GAIN Report # CH1009, Mar. 2, 2001, p. 33.

⁹⁹ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, p. 30.

The impact of WTO accession on U.S. exports of soybeans and soybean products to China is not expected to be large, according to recent USDA estimates,¹⁰⁰ largely because tariffs on soybeans and soybean meal have been set at only 3 percent and 5 percent, respectively, in recent years.¹⁰¹ Even though domestic demand for soybeans and soybean products will continue to be robust, imports of soybean oil are not expected to reach the TRQ limit of 3.26 million MT by 2006. The big concerns of industry analysts at this time is whether new Chinese regulations on GMOs will restrict product produced in the United States.¹⁰² Even without GMO restrictions, U.S. exports will continue to face competition from Argentina and Brazil in all products, as well as from India in soybean meal.

Cotton

China is the world's largest cotton-producing and consuming country.¹⁰³ For most of the 1990s, domestic demand for cotton to produce textiles and apparel made China a net importer,¹⁰⁴ peaking in 1995 when cotton imports reached \$1.4 million. Since then imports have declined and during 1999-2001, imports averaged about \$50 million annually. This decline was in response to China's systematic drawdown of its sizeable stockpile, which amounted to 4.6 million MT at the end of marketing year 1998/99 (July 31, 1999), equivalent to about one-half of world stockpiles.¹⁰⁵ During the same period, China subsidized exports of cotton were destined mainly for South Korea, Indonesia, Thailand, and Malaysia. By marketing year 2000/01, China's stockpile of cotton had declined to 2.5 million metric tons, or 30 percent of global cotton inventory.

The United States is the largest supplier of cotton to China, accounting for more than one-half of Chinese imports during 1997-2001. In 1997, Chinese cotton imports from the United States alone amounted to \$680 million. Australia's share of Chinese cotton imports has increased over time, reaching 30 percent of Chinese imports in 2001 (table A-12). Competitive factors favoring U.S. cotton exports are high-quality varieties and low costs relative to yield, coupled with efficient distribution and transportation networks. However, the United States faces stiff competition from Australia, which now has some of the lowest costs in the world relative to yield. Australian competitiveness is based on the increased used of GM cotton, the development of irrigation systems in the Northwest region of the country, and close proximity to China. Australia's competitiveness has also been helped by the strength of the U.S. dollar vis-à-vis the Australian dollar, which has made Australian product relatively cheap in the Chinese market. Uzbekistan, traditionally a major exporter of cotton, is unlikely to be competitive in the Chinese market owing to production constraints and low productivity. The United States (mainly from California) is also exporting high-quality, extra-long staple cotton to China. In this niche market, the United States competes strongly with Egypt.

¹⁰⁰ USDA, ERS, "WTO Accession Will Increase China's Agricultural Imports," *Agricultural Outlook*, Apr. 2002.

¹⁰¹ Conklin, N., "China's Accession to WTO: Implications for U.S. Agricultural Exports," USDA, ERS, presented at Agricultural Outlook Forum 2002, Feb. 22, 2002.

¹⁰² USDA, FAS, *China Oilseeds and Products Annual (part 1) 2001*, GAIN Report # CH1008, Mar. 9, 2001, pp. 26-27

¹⁰³ USDA, FAS, *Cotton: World Markets and Trade*, Mar. 2002.

¹⁰⁴ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, p. 50.

¹⁰⁵ USDA, FAS, *China Cotton and Products Annual 2001*, GAIN Report #CH1022, June 5, 2001.

China's WTO accession agreement calls for the establishment of a TRQ for cotton increasing to 890,000 MT by 2004. Analysts do not expect imports to reach the TRQ limit.¹⁰⁶ Chinese production is expected to rise in the future and with domestic prices close to international levels, imports will be limited.¹⁰⁷ The non-transparency of regulations dealing with how quotas will be administered could also adversely impact imports in the next few years.¹⁰⁸ Any Chinese imports will likely be sourced primarily from the United States or Australia.

The U.S. National Cotton Council (NCC) has stated that China is failing to implement its accession agreement on cotton and cotton products because only 48,500 MT (6 percent of the overall TRQ for cotton) has been allocated to private Chinese mills for general trade.¹⁰⁹ The other 94 percent of the TRQ reportedly face restrictions that deny national treatment to imported cotton by requiring that foreign cotton either be exported to third-country markets as manufactured goods or imported by STEs. Because STEs are controlled by the Chinese Government, NCC is concerned that cotton purchases for those entities will not be determined by market forces.¹¹⁰

Tobacco

China accounts for about 40 percent of world production and consumption of tobacco.¹¹¹ It is also the world's largest producer of cigarettes, manufacturing 1.7 trillion cigarettes in 2000. Chinese cigarettes have traditionally been low quality products, composed mainly of domestically-produced flue-cured tobacco. Government intervention, including restrictions on trade, has insulated China's tobacco industry from world markets and imports account for only a small fraction of consumption. However, shifts in Chinese domestic cigarette demand towards higher quality "American" type filtered cigarettes containing a blend of flue-cured, burley, and oriental tobaccos have coincided with increased imports of tobacco, primarily quality flue-cured varieties.

Between 1998 and 2001, imports grew from \$35 million to \$233 million, of which about 95 percent was supplied by the low cost producers, Zimbabwe and Brazil (table A-13). Until 2001, China maintained a ban on imports of U.S. leaf tobacco based on concerns of "blue-mold" disease which kept imports of U.S. tobacco at very low levels in recent years.¹¹² China also imported tobacco from Turkey and Thailand in recent years.

Under WTO accession, China is committed to reducing its tariffs on tobacco from 40 percent to 10 percent by 2005. This could result in imports increasing to 10 percent of the Chinese market.¹¹³ The lifting of the ban on U.S. imports, however, is unlikely to significantly increase the level of shipments to

¹⁰⁶ Conklin, N., "China's Accession to WTO: Implications for U.S. Agricultural Exports," USDA, ERS, presented at USDA's Agricultural Outlook Forum 2002, Feb. 22, 2002. Colby, H., "China's Cotton Trade Under the WTO," presented at USDA's Agricultural Outlook Forum 2002, Feb. 22, 2002.

¹⁰⁷ USDA, ERS, "WTO Accession Will Increase China's Agricultural Imports," *Agricultural Outlook*, Apr. 2002.

¹⁰⁸ USDA, FAS, *China Cotton and Products Cotton Update 2001*, GAIN Report #CH1036, Aug. 29, 2001.

¹⁰⁹ For quota allocated to private mills for general trade, Chinese regulations require import contracts to be signed before obtaining final clearance to import cotton, contrary to normal business practices. National Cotton Council, "Implementation of U.S.-China Bilateral Agreement on WTO Accession," July 2002, pp. 1-2, 5.

¹¹⁰ National Cotton Council, "Implementation of U.S.-China Bilateral Agreement on WTO Accession," July 2002, p. 4.

¹¹¹ USDA, FAS, *Tobacco: World Markets and Trade*, Circular Series FT-02-02 Feb. 2002.

¹¹² USDA, FAS, *China Tobacco and Tobacco Products Annual 2001*, GAIN Report #CH1019, May 8, 2001.

¹¹³ USDA, FAS, *China Tobacco and Tobacco Products Update 2000*, GAIN Report #CH0044, Dec. 11, 2000.

China as U.S.-produced leaf tobacco (mainly flue-cured and burley) is expensive relative to tobacco produced by other leading suppliers.¹¹⁴ Most other major supplier countries do not maintain production quotas,¹¹⁵ and prices are set by either the market, as in Zimbabwe and Malawi, or contracted by leaf traders and cigarette manufacturers at competitive prices, such as in Brazil. Importers likely will also find import regulations highly burdensome and imports will continue to be controlled by a STE.¹¹⁶

Animal Fat

Both China and the United States are large producing countries of animal fats. In most years, the United States is the leading world exporter of animal fats (including tallow, greases, lard, and fish oil) with a two-third share of world exports. Per capita consumption of animal fats in China is declining as consumers eat more meat and edible vegetable oils (such as soybean oil, peanut oil, and rapeseed oil).¹¹⁷ During 1997-2001, Chinese imports of animal fats, mostly lard and poultry fat, averaged about \$100 million annually and are still relatively small compared with trade in the leading vegetable oils like palm, soybean, and rapeseed oils (table A-14). Over the past 5 years, the United States supplied about 15 percent of China's imports of animal fats. Australia supplied about 35 percent and New Zealand 25 percent.

The United States is competitive in the production of animal fats, although it faces strong competition from other major livestock exporting countries such as Australia, New Zealand, and Canada. Australia and New Zealand enjoy lower transportation costs to China than the United States. Palm oil stearin from Malaysia is also competitive with U.S. animal fats in the Chinese market. WTO accession is likely to lead to a small increase in trade with tariffs being reduced from about 15 percent to 10 percent by 2004.

Hides and Skins

Production of hides and skin generally reflect demand for meat, dairy products, and wool as most hides are byproducts of other industries. The quantity of raw material produced depends in large part on the animal population. China is both a large producer and importer of cattle hides. The United States is the world's largest exporter of cattle hides and the leading supplier to China. During 1997-2001, Chinese imports more than doubled from \$356 million to \$775 million, of which the United States supplied \$143 million and \$400 million, respectively. The increase in imports resulted from a drop in stocks combined with a resurgence in leather fashion, including leather garments, shoe, and upholstery leather.¹¹⁸ China's hides and skin production has not kept pace with its processing capacity; thus leather tanners in China must rely on cattle hide imports to meet their tanning needs. Bovine hides account for about 80 percent of Chinese hides and skin imports, while sheep skins account for most of the remainder. Other important suppliers include Canada, Australia, the EU, and Brazil. Major suppliers of sheepskins to China include Australia, New Zealand, and the EU (table A-15). WTO accession will result in a drop in Chinese tariffs on hides and skins from less than 10 percent to zero by 2004. The United States will

¹¹⁴ USDA, FAS, *China Tobacco and Tobacco Products Annual 2001*, GAIN Report #CH1019, May 8, 2001.

¹¹⁵ Production quotas in the United States keep U.S. prices significantly higher than world prices, negatively impacting U.S. competitiveness in world markets.

¹¹⁶ USDA, FAS, *China Tobacco and Tobacco Products Chinese Import Procedures for Tobacco 2001*, GAIN Report #CH1014, May 4, 2001.

¹¹⁷ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, November 2001, pp. 32-33.

¹¹⁸ "Prices continue to rise," *Leather*, Oct. 2000, pp. 27-30.

likely continue to be the largest supplier to the Chinese market, although Australia will provide strong competition based on its proximity to the Chinese market.

Beef

During the 1990s, increased per capita income boosted the demand for beef in China, although, at only 10 pounds annually, it remains significantly below that of other Asian countries.¹¹⁹ Through mechanization, some modernization, and incentives to make use of available forages, Chinese beef production has kept pace with the general demand for beef. China's beef trade, which is very small compared with domestic production and consumption includes both exports and imports. Exports are mainly sent to Hong Kong, especially since disease concerns have closed off many markets traditionally supplied by the Chinese. Chinese imports consist of two types—muscle meat (60 percent) and offal (40 percent).¹²⁰ Muscle meat consists of both low-end cuts (sold at local restaurants and supermarkets) and high-quality grain-fed beef for high-end hotels and restaurants.¹²¹

In 2001, imports declined to \$5.8 million, of which the United States supplied 41 percent and Australia, 55 percent (table A-16). Small amounts of beef were supplied to the Chinese market by New Zealand and Canada in 2001. Although all four countries are efficient beef producers, their production systems differ—the United States and Canada are primarily grain-fed beef systems, Australia and New Zealand are primarily grass-fed beef systems. The Chinese market is highly price sensitive so that small changes in domestic prices and exchange rates have large effects on market shares. These factors currently favor imports from Australia and New Zealand, and to a lesser extent Canada, over the United States. Imports from other suppliers, primarily the EU and South American countries, have been limited by disease related issues.

WTO accession will lower tariffs on muscle meat from 45 percent to 12 percent, and tariffs on offal from 20 percent to 12 percent. The Chinese also eliminated the ban on U.S. products following the U.S.-China Agricultural Cooperation Agreement signed in April 1999. U.S. exports of beef likely will remain limited, however. This is largely because of efforts to improve beef quality in China, through imports of breeding cattle and animal genetics.¹²²

Pork

China accounts for over 50 percent of world pork production and consumption.¹²³ Pork dominates the livestock industry supplying almost 70 percent of total meat production.¹²⁴ Expansion in pork production has increased with the growth of per capita consumption, which, at 70 pounds annually is equivalent to that of the United States.¹²⁵ The increase has been met by expansion of production.

¹¹⁹ USDA, FAS, "Permanent Normal Trade Relations with China. What's at Stake for Beef," May, 2000.

¹²⁰ USDA, FAS, *China Livestock and Products Annual 2001*, GAIN Report #CH1033, Aug. 13, 2001.

¹²¹ USDA, ERS, *Briefing room. China: Outlook*, Dec. 28, 2000, at <http://www.ers.usda.gov/briefing/china/outlook.htm>, retrieved Oct. 17, 2001.

¹²² USDA, ERS, *China: Situation and Outlook*, WRS-98-3, July 1998, p. 32.

¹²³ USDA, FAS, *Livestock and Poultry: World Markets and Trade*, Circular Series DL&P, Mar. 2002.

¹²⁴ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, p. 38.

¹²⁵ USDA, FAS, "Permanent Normal Trade Relations with China. What's at Stake for Pork," Apr. 2000.

China's trade in pork is small. High tariffs and rigid import licensing have limited imports,¹²⁶ while exports have been constrained by disease problems and poor infrastructure (particularly refrigeration facilities).¹²⁷

Like beef, imports of pork represent a small share of domestic consumption. According to the USDA, all pork imports consist of offal (such as tongue, feet, and stomach) since imported muscle meat is not competitive with domestic product.¹²⁸ Although small, imports have grown significantly over the past 5 years, from \$2 million in 1997 to \$58 million in 2000, then dropping to \$42 million in 2001 (table A-17). This increase followed China allowing direct retail distribution of imported pork.¹²⁹ In 2001, the United States became the largest supplier of pork to the Chinese market, with a share of 42 percent, while the major competitors, the EU and Canada, supplied 32 percent and 24 percent, respectively.

The United States is highly competitive in the Chinese market but will continue to face competition from Canada and the EU. In the past, EU exports were enhanced by export refunds, however, restitution on fresh pig meat were terminated in June 2000. Nonetheless, pork production in several EU countries, Denmark in particular, has historically been export oriented and internationally competitive. Reflecting recent tightening of enforcement of SPS restrictions, particularly with respect to foot and mouth disease (FMD), imports from the EU have declined, which benefitted the United States and Canada.¹³⁰ FMD concerns also led to a ban on pork imports from Brazil into China. Canada's pork production sector is growing with its competitiveness enhanced by low feed costs and favorable exchange rates relative to the U.S. dollar.

Under China's WTO accession tariffs on pork offal are being lowered from 20 percent to 12 percent, while the VAT is being lowered from 17 percent to 13 percent. Also, China has committed to making its import procedures consistent and equitable, compared to recent measures that have been described as arbitrary and unpredictable.¹³¹ Lower tariffs and easier import procedures should benefit U.S. pork exporters.

Poultry

China is among the leading poultry producing and consuming countries in the world.¹³² Recent years have seen a substantial growth in China's poultry sector as poultry production has become more commercialized,¹³³ and growth in poultry consumption has risen to almost 20 percent of all meat consumption.¹³⁴ China is the world's second largest poultry importing country (behind Russia), and is

¹²⁶ USDA, ERS, *Briefing room. China: Outlook*, Dec. 28, 2000, at <http://www.ers.usda.gov/briefing/china/outlook.htm>, retrieved Oct. 17, 2001.

¹²⁷ USDA, ERS, *China: Situation and Outlook*, WRS-98-3, July 1998, p. 24.

¹²⁸ USDA, FAS, *China Livestock and Products Annual 2001*, GAIN Report #CH1033, Aug. 13, 2001.

¹²⁹ Before 1998, officially, the distribution of imported meats was limited to licensed importers selling to the hotel and restaurant trade.

¹³⁰ USDA, FAS, *China Livestock and Products Annual 2001*, GAIN Report #CH1033, Aug. 13, 2001.

¹³¹ USDA, FAS, *China Livestock and Products Semi-Annual 2001*, GAIN Report #CH1006, Feb. 8, 2001.

¹³² USDA, FAS, *Livestock and Poultry: World Markets and Trade*, Circular Series DL&P, Mar. 2002.

¹³³ USDA, ERS, *Briefing room. China: Outlook*, Dec. 28, 2000, at <http://www.ers.usda.gov/briefing/china/outlook.htm>, retrieved Oct. 17, 2001.

¹³⁴ USDA, ERS, *China Agriculture in Transition*, WRS-01-2, Nov. 2001, p. 38.

also a leading world poultry exporter. Imports consist mostly of wings, feet, and offal.¹³⁵ Broilers are also imported which are cut, packaged, and re-exported to Japan and South Korea.¹³⁶

Chinese poultry imports amounted to \$443 million, compared to imports of about \$100 million in the mid-1990s. This growth was generated by strong domestic demand not matched by domestic production (table A-18). In recent years, the United States has supplied about 80 percent of Chinese poultry imports. Other countries supplying the Chinese poultry markets traditionally have been the EU and Canada. In recent years, Thailand has emerged as an important source of imports.

The United States faces strong competition from other low-cost poultry producing countries, such as Argentina, Brazil, the EU, and Thailand. Argentina and Brazil benefit from low feed costs (feed accounts for one-half to three-fourths of the cost of producing poultry in major producing countries) and new, state-of-the-art processing facilities.¹³⁷ Investment in new processing technology, coupled with low labor and transportation costs has made Thailand extremely cost-competitive in the production of high-valued, semi-processed poultry products.¹³⁸ EU poultry producers can compete in the Chinese market owing to low internal EU grain prices and government assistance in the form of export refunds.

The United States is likely to continue its domination of the market following China's WTO accession. Under the terms of the U.S.-China Agricultural Cooperation Agreement, China agreed to remove all bans of U.S. poultry accompanied by appropriate USDA certification. At the same time, China agreed to lower tariffs on poultry from 20 percent to 10 percent by 2004. However, the 2002 Chinese tariff schedule posted specific tariffs for poultry, not an ad valorem as required under the WTO commitment. The United States has expressed concern that the effective ad valorem equivalent of the specific tariff might exceed the commitment rate.¹³⁹ New Chinese regulations on product labeling also have the potential to disrupt trade, according to USDA sources.¹⁴⁰

Dairy

Traditionally, China has not been a major producer and consumer of dairy products. Per capita consumption is roughly 7 kilograms per year (less than 2 gallons of milk),¹⁴¹ compared with a world average of almost 100 kilograms.¹⁴² However, demand is increasing with income growth, especially the demand for fresh milk, yogurt, and ice cream. A recent government school milk program has also boosted fluid milk consumption.¹⁴³ Growth of fast-food and pizza restaurants in the major cities has also increased demand for butter and cheese.¹⁴⁴ Although domestic production has been increasing, it has failed to keep pace with demand growth, and thus China has increasingly turned to imports to fill the gap.

¹³⁵ USDA, FAS, "Permanent Normal Trade Relations with China. What's at Stake for Poultry," Apr. 2000.

¹³⁶ USDA, ERS, *China: Situation and Outlook*, WRS-98-3, July 1998, p. 43.

¹³⁷ U.S. International Trade Commission, *Industry & Trade Summary: Poultry*, publication no. 3148, Dec. 1998.

¹³⁸ "Thailand: A Leader in the Broiler Business," *Poultry International*, Oct. 2000, pp. 24-26.

¹³⁹ USDA, FAS, *China Poultry and Poultry Products Semi-Annual 2002*, GAIN Report #CH2006, Feb. 1, 2002.

¹⁴⁰ USDA, FAS, *China Poultry and Poultry Products Annual 2001*, GAIN Report #CH1034, Aug. 15, 2001.

¹⁴¹ U.S. Dairy Export Council, "Market overview: Heeding the roar of the Dragon," *Export profile*, vol. 10, no. 1, Apr. 2000.

¹⁴² USDA, FAS, *China Dairy and Products Annual 2000*, GAIN Report #CH0037, Oct. 31, 2000.

¹⁴³ U.S. Dairy Export Council, "Market overview: Heeding the roar of the Dragon," *Export profile*, vol. 10, no. 1, Apr. 2000.

¹⁴⁴ USDA, FAS, *China Dairy and Products Annual 2001*, GAIN Report #CH1040, Nov. 1, 2001.

Chinese dairy imports reached \$218 million in 2001, an almost four-fold increase from the 1997 import level of \$63 million (table A-19). Imports consist mainly of nonfat dry milk, wholemilk powder, whey, and a small volume of fluid milk. Chinese imports of butter and cheese are negligible. Almost all Chinese milk powder imports are supplied by New Zealand and Australia, while whey is supplied by the EU and United States. Close to 75 percent of Chinese dairy imports from the United States consisted of whey in 2001, which are used to produce milk drinks, yogurt, ice cream, and infant formulas.¹⁴⁵

Under the terms of WTO accession, China will make significant cuts in its tariffs on dairy products. For example, cheese tariffs will go from 50 percent to 12 percent by 2004, and tariffs on lactose, yogurt and food preparations containing dairy products (ranging from 25 percent to 45 percent) will be reduced to 10 percent. Ice cream tariffs will fall from 45 percent to 19 percent. With these reductions, one estimate is that U.S. exports to China could reach \$135 million annually.¹⁴⁶

Competitive factors likely will mean that the United States will continue to export whey, and dairy ingredients for food processing (such as lactose and dairy-based food preparations),¹⁴⁷ in which the United States is highly efficient in production and marketing. U.S. support prices for milk powders make U.S. product uncompetitive in world markets without subsidies.¹⁴⁸ U.S. exports of cheese to China should also expand in the future with growth in the country's fast-food sector.¹⁴⁹ With subsidies being reduced, or perhaps eliminated, under a new WTO Agreement on Agriculture, U.S. products will not be competitive with New Zealand and Australia, which also benefit from proximity to the Chinese market.

Fresh and Processed Fruits and Vegetables

China is the world's largest fruit and vegetable producing country, with fruit production double that of the United States, and vegetable production seven times larger.¹⁵⁰ Climate and soil enable China to produce a wide variety of fruits and vegetables, including cold weather deciduous fruits (such as apples, pears, and peaches) in the north, to tropical products (such as banana, mangos, papaya, and citrus) in the south. China also grows numerous vegetable products (such as lettuce, tomatoes, mushroom, and herbs) throughout the country. Chinese production of fruits and vegetables has increased in recent years in response to growing consumer demand for higher-valued food products.¹⁵¹ Government intervention in the sector has also been minimal enabling producers to respond to changing consumer demands. China also benefits from low labor costs (as low as \$2 per day)¹⁵² in producing fruits and vegetables which

¹⁴⁵ U.S. Dairy Export Council, "Market overview: Heeding the roar of the Dragon," *Export profile*, vol. 10, no. 1, Apr. 2000.

¹⁴⁶ U.S. Dairy Export Council, "Passage of China trade bill will boost U.S. dairy exports," press release, Sept. 20, 2000.

¹⁴⁷ USDA, FAS, "Permanent Normal Trade Relations with China. What's at Stake for Dairy," May, 2000.

¹⁴⁸ U.S. Dairy Export Council, "Market overview: Heeding the roar of the Dragon," *Export profile*, vol. 10, no. 1, Apr. 2000.

¹⁴⁹ U.S. Dairy Export Council, "Passage of China trade bill will boost U.S. dairy exports," press release, Sept. 20, 2000.

¹⁵⁰ USDA, ERS, "China's Fruit and Vegetable Sector: A Changing Market Environment," *Agricultural Outlook*, June-July 1999, pp. 10-13.

¹⁵¹ USDA, ERS, *Briefing room. China: Outlook*, Dec. 28, 2000, at <http://www.ers.usda.gov/briefing/china/outlook.htm>, retrieved Oct. 17, 2001.

¹⁵² USDA, ERS, "China's Fruit and Vegetable Sector: A Changing Market Environment," *Agricultural Outlook*, June-July 1999, pp. 10-13.

typically are highly labor intensive.¹⁵³ However, produce quality is low and imported product is favored by China's hotel/restaurant trade.

China's imports of fresh fruit reached \$288 million in 2001 compared to \$175 million in 1997 (table A-20). During this period, between one-third and one-half of imports have been bananas, supplied mainly by the Philippines and Ecuador (the United States does not produce or export bananas). Fresh grapes are also a major import of China (reaching \$35 million in 2001), almost exclusively supplied by either Chile or the United States. China's imports of citrus fruit have grown steadily in recent years, especially oranges, mostly supplied by the United States in competition with New Zealand.¹⁵⁴ The United States also competes with New Zealand for China's growing import demand for fresh apples.¹⁵⁵ China also imports dates, figs, pineapples, logans, and curians, none of which are supplied by the United States in significant quantities. China's overall imports of fresh vegetables from all suppliers are very low and are falling, averaging less than \$5 million annually during 1997-2001 (table A-21). Shipments from the United States, consisting principally of onions, mushrooms, and miscellaneous leguminous and other fresh vegetables, averaged \$2.6 million annually, and declined steadily throughout 1999-2001. Other suppliers of fresh vegetables to China include New Zealand, the EU, and North Korea. China's imports of processed fruits and vegetables averaged \$164 million annually between 1997 and 2001 (table A-22).¹⁵⁶ Over the past 5 years, the United States supplied about 20 percent of Chinese imports of processed fruits and vegetables, about three-quarters of which consisted of processed potatoes. Other imports from the United States include sweet corn, frozen orange juice, and prunes.

According to the USDA, China's entry into the WTO is expected to benefit U.S. exporters of fruits and vegetables.¹⁵⁷ Tariffs on several products imported from the United States are being cut substantially (for example: oranges, 40 percent to 12 percent; frozen potato fries, 25 percent to 13 percent). Also, the ban on U.S. citrus over concerns about fruit fly infestations was lifted under accession negotiations between the United States and China.¹⁵⁸ Perhaps the most important opportunity for the United States will be in exports of frozen potato fries which are in increasing demand from the rapidly growing Chinese fast-food sector.¹⁵⁹ However, U.S. exporters will continue to face stiff competition from Canada which also sees opportunities to expand sales to China.

¹⁵³ USDA, ERS, *Briefing room. China: Trade*, Dec. 27, 2000, at <http://www.ers.usda.gov/briefing/china/trade.htm>, retrieved Oct. 17, 2001.

¹⁵⁴ Sales of U.S. oranges in China have increased steadily over the last 12 months due to the declining duty, and total sales for 2002 are expected to double from 2001 levels. Interview with U.S. citrus industry sources, July 19, 2002.

¹⁵⁵ Chinese trade barriers against U.S. pears and certain varieties of apples have remained in place over the last 12 months because of continued U.S. SPS restrictions on Chinese apples and pears. Interview with U.S. horticultural industry sources, July 19, 2002.

¹⁵⁶ The sharp increase in imports from \$164 million in 2000 to \$319 million in 2001 resulted from imports of cassava from Thailand.

¹⁵⁷ USDA, FAS, *Fact sheet. Permanent Normal Trade Relations with China. What's at Stake for Fresh and Processed Fruits and Vegetables?* May 2000. USDA, ERS, "China's Fruit and Vegetable Sector: A Changing Market Environment," *Agricultural Outlook*, June-July 1999, pp. 10-13.

¹⁵⁸ This ban was dropped under the U.S./China agricultural cooperation agreement of April 1999. Source: U.S.-China Agricultural Cooperation Agreement. Removal of Sanitary/Phytosanitary Barriers to U.S. Exports, Fact sheet, Feb. 15, 2000, at <http://www.mac.doc.gov/China/Docs/agriculturefactsheets/agriculturebilat.htm>, retrieved Mar. 20, 2002.

¹⁵⁹ Sales of U.S. frozen french fries and other frozen potato products in China have increased significantly over the last 12 months, but the 17.8 percent duty on imports into China remain a barrier to even higher growth rates. Interview with U.S. potato industry sources, July 25, 2002.

CONCLUSIONS

China's accession to the WTO has been widely supported by U.S. agricultural interests. With a population of 1.3 billion and rapid per capita income growth, China has the potential to be a huge market for U.S. agricultural exports. Although much of the analytical work on China's WTO accession has indicated huge potential benefits, it is becoming increasingly clear that exporters face an uphill battle before this potential is realized.

Specifically, we discussed three major hurdles that exporters must overcome in order for U.S. agricultural exports to expand in the wake of WTO accession. The first hurdle deals with implementation of WTO market access commitments. China must implement its WTO commitments, as highlighted in the USTR's recently published Trade Policy Agenda for 2002. The second hurdle concerns Chinese domestic regulations that impact imports. These are Chinese domestic regulations, not necessarily linked to the accession agreement, but they will nonetheless impact future U.S.-China trade. The third hurdle concerns U.S. competitiveness in the Chinese market vis-à-vis its major international competitors. Although U.S. exporters have access to the Chinese market, so do agricultural competitors such as Australia, Brazil, Argentina, and the EU. Because China is highly price sensitive in making its import decisions, a tough fight among world exporters over future sales to China can be expected.