The High Cost of the China-WTO Deal

Administration's own analysis suggests spiraling deficits, job losses

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No one can predict the future. But the Clinton Administration is confidently forecasting that the huge U.S. trade deficit with China will improve if Congress accords China permanent normal trade relations (PNTR) in order to accommodate Beijing's membership in the World Trade Organization (WTO). President Clinton claims that the recently signed trade agreement with China "creates a win-win result for both countries" (Clinton 2000, 9). He argues that exports to China "now support hundreds of thousands of American jobs," and that "these figures can grow substantially with the new access to the Chinese market the WTO agreement creates" (Clinton 2000, 10). Others in the White House, such as Kenneth Liberthal, the special advisor to the president and senior director for Asia affairs at the National Security Council, echo Clinton's assessment:

"Let's be clear as to why a trade deficit might decrease in the short term. China exports far more to the U.S. than it imports [from] the U.S….It will not grow as much as it would have grown without this agreement and over time clearly it will shrink with this agreement."1

These claims are misleading. The Administration has proposed to facilitate China's entry into the WTO at a time when the U.S. already has a massive trade deficit with China. In 1999, the U.S. imported approximately $81 billion in goods from China and exported $13 billion – a six-to-one ratio of imports to exports that represents the most unbalanced relationship in the history of U.S. trade. 2 While exports generated about 170,000 jobs in the United States in 1999, imports eliminated almost 1.1 million domestic job opportunities, for a net loss of 880,000 high-wage manufacturing jobs. 3

China's entry into the WTO, under PNTR with the U.S., will lock this relationship into place, setting the stage for rapidly rising trade deficits in the future that would severely depress employment in manufacturing, the sector most directly affected by trade. China's accession to the WTO would also increase income inequality in the U.S. 4

Despite the Administration's rhetoric, its own analysis suggests that, after China enters the WTO, the U.S. trade deficit with China will expand, not contract. The contradiction between the Administration's claims and its own economic analysis makes it impossible to take seriously its economic argument for giving China permanent trade concessions.

The trade commission's analysis

The U.S. government's most comprehensive economic case for the China-WTO deal, conducted by the U.S. International Trade Commission (USITC), argues that China's accession to the WTO would increase U.S. exports to that country by 10.1%, while U.S. imports from China would grow by only 6.9%. 5 However, the absolute level of the trade deficit continues to grow, despite the higher growth rate for U.S. exports, because the volume of imports ($81 billion in 1999) was so much larger than the volume of exports ($13 billion) 6

Following the USITC's own logic, assume that imports and exports continue to grow in the future at the rates predicted by its model. How long would it take before the trade deficit narrows? As shown in Figure 1, it will take 50 years before the U.S. trade deficit with China stops expanding-with a peak deficit of $649 billion in 2048. 7 The trade deficit would not fall below its current level, on these assumptions, until 2060, more than 60 years after the completion of the China-WTO agreement.

In reality, the deficit path shown in Figure 1 is unsustainable, and would lead to a financial crisis long before the deficit with China reached anything approaching $600 billion. But this analysis, the Administration's best case, illustrates the danger that a rapid growth of the bilateral trade deficit would pose for U.S. employment in the future. Even if these trends persisted for just the next 10 years, then the U.S. deficit with China would reach $131 billion in 2010. The growth in exports to China would create 325,000 jobs in this period, but imports would eliminate 1.142 million domestic job opportunities. 8 On balance, 817,000 jobs could be eliminated by the growth in the trade deficit with China over the next decade, and these losses would come on top of the 880,000 jobs the U.S. has already lost due to its current trade deficit with that country.

The USITC's questionable assumptions

Moreover, many of the assumptions informing the USITC analysis are overly optimistic and flawed, suggesting that the near-term costs of China's entrance into the WTO may be larger.

Assumption: China will comply with all terms of the accession agreement

Statements by Chinese officials since the accession agreement was completed in November 1999 raise serious doubts about China's willingness to comply with the deal and about the ability of the U.S. to enforce the terms of the agreement.

For example, the U.S. Trade Representative's (USTR) summary of the accession agreement claimed, "China will establish large and increasing tariff-rate quotas for wheat…with a substantial share reserved for private trade." But according to news reports, Long Yongtu, China's chief trade negotiator, recently "said that, although Beijing had agreed to allow 7.3 million tonnes of wheat from the United States to be exported to the mainland each year, it is a 'complete misunderstanding' to expect this grain to enter the country. In its agreements with the U.S., Beijing only conceded a theoretical opportunity for the export of grain." 9

The USTR has also claimed that “China’s commitments will eliminate broad systemic barriers to U.S. exports [of petroleum products], such as limits on who can import goods and distribute them in China.” A senior Chinese official, however, recently said that “the state will retain its monopoly over the import of oil and petroleum after the country enters the World Trade Organization.” The official added that, “if these three [state-owned] companies do not import, it is impossible for petroleum to enter China. Therefore, there will not be a problem in terms of price linkage or large-scale foreign oil imports.” 10

The USITC also assumed that China will eliminate non-tariff barriers (NTB) to trade and investment in a number of areas, including licensing and quotas, state trading, and offsets. If China fails to eliminate these NTBs, the effects of the tariff cuts included in the accession agreement will be reduced or eliminated. But as the preceding quotes from senior Chinese officials make clear, China is unwilling or unable to remove NTBs in a number of key sectors.

The USITC is careful to point out that the benefits to be obtained depend on the effective removal of these trade barriers in China. For example, in the area of licensing and quotas, the “potential benefits [for U.S. exports] may depend on Chinese government industrial and agricultural policies, as well as the role of state trading companies” (USITC Table ES-1, p. xi). On offsets, the commission notes that “U.S. export opportunities [depend] upon the degree to which voluntary collaboration replaces government mandated offsets in sales” (USITC Table ES-1, p. xiii). In other words, informal trade barriers could easily replace the formal trade restrictions that will be eliminated under the accession agreement. The failure of the United States to improve its trade deficit with China, as it failed to do previously with Japan despite the conclusion of numerous market-opening agreements, suggests that such informal NTBs can easily negate the benefits promised under the agreement.

Assumption: China will not devalue its currency

It wasn’t long ago that the Clinton Adm
inistration claimed that the North American Free Trade Agreement (NAFTA) would create both a large number of U.S. jobs as well as substantial economic benefits for workers and consumers in the United States, Canada, and Mexico. In reality, since NAFTA took effect on January 1, 1994, workers in all three countries have suffered, each for different reasons (EPI et al. 1999).

The U.S. trade deficit with the NAFTA countries expanded from $9.1 billion in 1993 to $32.0 billion in 1998 (U.S. Department of Commerce 1999). As a result, 440,000 jobs were eliminated in the United States, with losses occurring in every state (Scott 1999b).

The NAFTA deficit expanded in part because, shortly after the agreement took effect, Mexico devalued the peso in 1995 to increase the competitiveness of Mexican products in the United States. In addition, U.S. firms rapidly expanded foreign direct investment (FDI) in Mexico, expanding capacity to produce goods for export to the U.S. market (Scott 1999b).

The USITC’s estimates of the benefits of that agreement assume fixed exchange rates (USITC 1999, Table ES-4, p. xix). But China will most likely follow a cycle similar to that of Mexico: sometime after China enters the WTO, it will experience a currency crisis and devaluation, which will be followed by surging FDI and then rapidly expanding trade deficits. China’s last devaluation occurred in 1994, and China has experienced several years of double-digit inflation since then. A substantial devaluation by China would cause a huge increase in China’s exports to the United States and a reduction in U.S. exports to China. These effects could easily offset any and all trade benefits that the United States hopes to gain from the China-WTO accession agreement.

Assumption: the services agreement and elimination of apparel quotas will not increase trade deficits
The expansion of trade in distribution and financial services, such as banking, insurance, and telecommunications, is also likely to increase the U.S. trade deficit. The USITC's study did not quantify the costs and benefits of the services agreements, but the U.S. experience under NAFTA has demonstrated that the primary impact of expanding services trade has been to facilitate the growth in FDI in manufacturing enterprises.

The main purpose of U.S. multinational banks and other services providers in developing countries is to provide logistical support for multinational businesses engaged in production activity. The tremendous growth in FDI in Mexico after NAFTA was greatly facilitated by the growth of U.S. services investments.

In its estimates of the impacts of the agreement on exports and imports, the USITC staff also failed to include the effects of removing the U.S. quotas on textile and apparel imports from China.[11] It is extremely likely that U.S. apparel imports will surge rapidly if quotas on Chinese apparel imports are lifted, and what remains of the U.S. apparel industry, which employed nearly 700,000 workers in 1999 (U.S. Bureau of Labor Statistics 1999), would face rapid extinction if these quotas were phased out. The elimination of these quotas would also result in a substantial increase in the U.S. trade deficit with China and the world.

Conclusion
The U.S. government's most comprehensive assessment of the costs and benefits of the China-WTO deal shows that the U.S. trade deficit with China would continue to increase for the foreseeable future, even under unrealistically optimistic assumptions. Even so, supporters still ask us to believe that the benefits from the agreement will be great, and that they will exceed its costs "in the short term." The available economic analyses and the recent experience of the United States with NAFTA strongly suggest the China-WTO agreement is a bad deal for the U.S. and its workers.

ENDNOTES

1. *NewsHour with Jim Lehrer* transcript. 1999. "Online NewsHour: Opening Trade – November 15, 1999." < http://www.pbs.org/newshour/bb/asia/july-dec99/wto_11-15.html >

2. Census Bureau (1998 and 1999), Tables 14 and 14a, and author's calculations. Estimated trade flows for 1999 based on data for January through November, and comparisons with trade flows for year-to-date and complete year of 1998.

3. These employment estimates assume that each $1 billion of exports generates 13,000 jobs in the domestic economy, following Huffbauer (1999), and vice versa for imports. See Scott (1999a) and Scott and Rothstein (1997) for further details on the relationships between employment in the U.S. and trade with China.

4. Isabell Sawhill notes that the incomes of the top 20% of families in the 1990s were 11.4 times those of the bottom 20% of families. She also notes, as paraphrased by John Berry in The Washington Post (Berry 2000, A14), that the "gap is wider than it has been at any point since World War II. And while the quality of the available data for earlier in the century is poor, it appears that the inequality may be the highest it has been since the late 1920s…."

5. Note that these estimates reflect the impact of the April 1994 tariff offer, and do not include the effect of changes in other non-tariff barriers (USITC 1999, Table ES-4, p. xix). The elimination of non-tariff barriers in services and the phasing out of U.S. quotas on imports of apparel from China are also likely to increase the U.S. trade deficit with China.

6. The USITC estimates that U.S. exports to China will increase by $2.7 billion and that imports will rise by $4.4 billion, including both the static effects of reduced trade barriers and the dynamic effects of productivity growth and capital accumulation (USITC 1999, Table ES-4, p. xix). These estimates are based on the "specific tariff and market access offers respectively, made by China in April 1999." These offers were more generous than the actual terms of the final accession agreement between the U.S. and China, reached in November 1999. However, the USITC had not been asked to prepare revised estimates of the impact of the final accession agreement at the time of preparation of this report (Arona Butcher, personal correspondence, January 2000).

7. The USITC study uses a general equilibrium model to estimate the "static and dynamic" effects of China's entry into the WTO. Such models assume that the two economies would instantly adjust to new equilibrium levels of trade and investment. The forecast derived from that model assumes that imports and exports continue to grow at the rates estimated by the USITC through 2060, as discussed below. While such long-term forecasts cannot reliably predict the level of future trade flows, they do provide an important illustration of the dynamic effects of integrating China into the WTO under the terms of the accession agreement.

8. These estimates assume no change in output/employment relationships in this period. Productivity growth and changes in the price levels are likely to change substantially in this period. Productivity growth will also eliminate many manufacturing jobs, and the number of job losses attributable to changes in exports and imports would also decline, proportionately. However, the net effects of increasing trade deficits would still be very large and significant in the U.S. during this period.

9. *South China Morning Post*, January 7, 2000, as cited by Elizabeth Drake, Research Department, AFL-CIO in memo: "Will China Comply With WTO rules? Not According to Chinese Government Officials."

10. Ibid.

11. USITC 1999. See "Additional views of commissioner Stephen Koplan," following Chapter 8.

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