The New U.S. – China Trade Agreement and Arizona Cotton

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Abstract

Gaining greater access to export markets, particularly Asian markets, is important to Arizona cotton producers. Over 80 percent of Arizona's cotton shipments are exports, roughly double the U.S. average. Asian countries typically account for half of world cotton imports. Relative to the rest of the United States, Arizona (along with California) has a location advantage supplying these markets. In November 1999 the United States and China signed a trade agreement to reduce China's trade barriers and win U.S. support for China's entry into the World Trade Organization (WTO). According to recent USDA projections, the agreement would increase China's net cotton imports by $359 million when fully implemented in 2005 and by $328 million per year between 2000-09. Political uncertainty surrounds the timing of China's accession to the WTO, however, and China's return to cotton net-importer status could be delayed by Chinese policies to draw down their large accumulation of cotton stocks.

On November 15, 1999 U.S. Trade Representative Charlene Barshefsky and China's trade minister, Shi Gaungsheng, signed an historic agreement to reduce China's barriers to trade and win U.S. support of China's entry into the World Trade Organization (WTO). Some China observers believe the potential importance of this agreement far eclipses that of any other China policy development since the warming of U.S. – Chinese relations of the Nixon years. The potential implications for the United States are enormous – the expansion of trade and even business ownership opportunities in the world's most populous country. China has already made great strides toward a thriving market economy. Yet it has many trade barriers still in place. Here we focus on the implications of China WTO accession for Arizona cotton.

Setting the stage: China and the potential for trade

China's population of nearly 1.25 billion people is more than four times that of the United States. Between 1981 and 1990, China's growth in real GDP per capita averaged 7.7 percent per year, and in the 1990s, its real GDP per capita increased at an even faster pace. In fact, China's real GDP per capita growth rate has far outstripped that of any other county. Over the same years (1981-1997), the rate of growth in U.S. real GDP per capita usually ran less than 2 percent per year (CIA). But, while China has grown and reduced some of its barriers to trade, major barriers remain. According to the office of the U.S. Trade Representative, "China has used prohibitively high tariffs … in combination with other import restrictions and foreign exchange controls to protect its domestic industry and restrict imports. … These high nominal tariff rates … contribute to inefficiencies in China's economy and pose a major barrier to U.S. commercial opportunities. … China still maintains a large number of non-tariff administrative con-

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trols to implement its trade and industrial policies." With these market and trade conditions, removing trade barriers could create important opportunities for U.S. commerce.

Basics of the Agreement, and Hurtles Remaining

Under the agriculture-related provisions of the new U.S.-China agreement, China will reduce its tariffs and other barriers to agricultural trade. In exchange, the United States will, among other provisions, abandon quotas on textile imports from China in 2005, and most importantly, support China's bid to become a member of the World Trade Organization (WTO).

Before WTO members can take up China's application to join the 135-country organization that sets and enforces the rules for international commerce, China must complete bilateral agreements with the European Union, Canada, and some developing countries. Although the U.S. – China agreement augers well for a positive outcome to the others, some of those negotiations could prove difficult. Even the U.S. position on China's entry into the WTO is not completely settled. Although the U.S. Congress does not vote on the agreement *per se*, it must (by WTO requirements) vote to put an end to the annual U.S. review of China's trade status with the United States and establish normal trade relations with China. The annual review of China's trade status has frequently erupted into contentious debates about issues not directly related to trade – charges of illegal political contributions, theft of nuclear secrets, human rights violations, and saber rattling against Taiwan. The recent WTO meetings held in Seattle provided graphic illustration of the contentious nature of the U.S. debate over China's entry into the WTO. Opponents making their voices heard in Seattle promised to fight normalizing U.S.-China trade relations. Thus, while congressional trade promoters hope that the trade issue can be separated from more disagreeable components of our relationship with China, they recognize the battle for U.S. support of China's entry into the WTO is not yet won.

Trade Policy Important for Arizona Cotton

Access to export markets, particularly Asian markets, is important to Arizona cotton producers. USDA's Economic Research Service releases data periodically on cotton exports by state. Recent reports cover the years 1975, 1980, 1986, and, most recently, the 1993/4 season (Glade and Johnson, and Glade, Johnson and Meyer). Since 1980, over 80 percent of Arizona cotton shipments have been bound for export markets (figure 1). By comparison, the United States as a whole shipped less than 55 percent of its cotton for export in 1980. This share fell to 48.1 percent in 1986 and further to just 37 percent in 1993/4. Asian countries typically import about half the cotton traded in the world market. Arizona and California have a location advantage supplying these markets relative to the rest of the United States (Wade and Tronstad, 1993). On the other hand, U.S. domestic mills are located primarily in the Southeast, giving Arizona producers a location disadvantage at home.

The Uruguay Round of GATT, concluded in 1994, was the first effort by that world trading organization to significantly reduce agricultural import quotas and other barriers to agricultural trade. The Economic Research Service (1994) estimated that the Uruguay Round of the GATT agreement would increase incomes worldwide, and especially those in middle-income countries with a high propensity to spend added income on apparel. These income effects, along with efficiency gains in the textile industry brought on by reduced barriers to textile trade, increase the demand for cotton. The Economic Research Service projected that as a result of the Uruguay Round, by 2005 the trade agreement will increase annual U.S. exports of cotton by 9-10 percent, and domestic prices for cotton will have increased about 5 percent above levels without the agreement.

Enter China

China plays a huge role in the international cotton market. China is the world's largest consumer of cotton and home of the world's largest textile industry. In most years, China accounts for nearly one fourth of total world consumption (Glade, Edward, Jr., Leslie Meyer, and Harold Stults). Equally important, China has swung back and forth between being a large exporter to large importer of cotton. In 1981, China was a net importer of over 2 million bales of cotton (figure 2). From 1985-7 they were net exporters, averaging 2.7 million bales per year. From 1989-91, China was again a net importer, averaging over 1 billion bales. Between 1994-7, net imports ranged from 3 to 3.9 million bales. So, China has often imported an amount equal to a fourth to a half of total US cotton exports, and during the late 1980s China exported a third of the amount exported by the United States. More recently China has become a net exporter again, exporting 1 million bales in 1999. However, recent USDA baseline projections to the year 2009 estimate that China's net exports will decline and that China will once again become a net importer by 2002. USDA projects that China's net imports will grow to 1.7 million bales by 2006 and hold steady after that. These projections do not account for any increase in China's demand for cotton resulting from WTO accession.

Historically, China's central planning promoted one sector, and then another, leading to huge swings in agricultural production. These domestic agricultural policies distorted China's comparative advantages in agricultural trade. Also, China's national and provincial governments still use the super-STEs (State Trading Enterprises) to conduct cotton trade (Ackerman). Critics of STEs charge that they provide a cover by which countries can hide trade-distorting export subsidies and import tariffs. Under the new U.S. – China agreement, STE trade-distorting powers should be reduced. And, if China gains membership in the WTO, China's domestic and STE policies would be subject to WTO scrutiny and enforcement procedures.

Agreement Provisions Affecting Cotton

Under its bilateral agreement with the United States, China has tentatively committed to a number of reforms in several agricultural markets. Colby, Price and Tuan (2000) report details of overall agricultural provisions. Here we focus on provisions that most directly affect cotton:

> China will expand access to its cotton market by replacing its cotton import quotas with a system of tariff-rate quotas (TRQs). China committed to a TRQ of 743,000 tons (over 3 million bales) for cotton in 2000. Imports at or below this level would be assessed a relatively low, 4-percent duty. Above this amount the duty would be 69 percent. By 2004 the TRQ would rise to 894,000 tons (over 3.7 million bales) and the over-quota would decline to 40 percent. The high over-quota duties effectively prohibit imports above the TRQ levels. However, USDA projections suggest China's demand for cotton imports will remain below this limit over the next 5 years.
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> To increase private sector participation in trade, non-state trading enterprises will be awarded 67 percent of each year's TRQ.
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> China will end its use of export subsidies for cotton and other agricultural commodities.
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> Trade-distorting domestic agricultural subsidies will be capped and reduced over time.
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> Sanitary and phytosanitary (SPS) barriers must be based on scientific evidence.
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> Under the agricultural provisions of the Uruguay Round Agreement, developed country import quotas for textiles and apparel under the Multifiber Arrangement will be phased out for all WTO members by 2005. Accordingly, if China becomes a WTO member, developed country barriers to its textiles exports will be reduced.

There is no guarantee that the level and timing of China's commitments will exactly match those of the U.S.-China agreement. China must still negotiate bilaterally with other WTO Members and the United States and other WTO Working Party Members must agree on a final set of commitments before China will be allowed WTO membership.

Implications for U.S. Cotton

In a 1997 study, Wang estimated the importance of China's accession into the WTO. Wang and colleagues recognize China's resource endowments, and the comparative advantage that its large population gives to it in the production of labor-intensive goods – especially textiles and apparel. His study also recognizes China's trade distorting polices and postulates how accession into the WTO might change those policies. Under more market-oriented, freer trade policies, China's labor-intensive sectors would expand, and bid away resources from farming. The bottom line, according to Wang's study, is that China will import more cotton under WTO membership (Lopez and Wang).

USDA recently released projections of the impact of China's accession to the WTO at its 2000 Outlook Forum in late February. This new analysis compares long-range projections with and without China's WTO accession and reports commodity-specific impacts including those for cotton. In the baseline (without accession) China is projected to return to being a net importer of cotton by 2002 and to continue to be a net importer through 2009. When fully implemented in 2005, WTO accession would increase China's net cotton imports by $359 million in that year (from $565 million without WTO accession to $924 million with accession). On average, China's net cotton imports would increase above the baseline by $328 million per year between 2000-09 (Colby, Price and Tuan).

Uncertainties Remain

As we noted at the outset, the exact terms and timing of China's accession to the WTO remains uncertain. In February 2000 Chinese and EU diplomats broke off bilateral negotiations over China's entry into the WTO (Collier) without an agreement. No date has been set for future talks. China must complete bilateral negotiations with the EU and other WTO members before its final admissions package can go forward for approval. In the U.S. Congress, action on a bill to confer normal trading relations to China is being held up until China completes its bilateral agreements with its other major trading partners. The AFL-CIO, citing concerns over China's labor practices, opposes China's entry into the WTO and has announced plans to run TV adds in several congressional districts this year (Burkins). Given the volatility of this issue coming up in an election year, it is uncertain how and how quickly China will ultimately lower its agricultural trade barriers.

Another near-term uncertainty is how China will manage its cotton stocks. In the mid-1990s China's cotton pricing and procurement policies encouraged a large accumulation of cotton stocks, which rose from 6 million bales in 1993 to 17 million bales in 1998. In 1999, the Chinese government abolished its set price for cotton and its requirement of mandatory sales of cotton to the government. While these measures should reduce Chinese cotton acreage and production, the costs of carrying stocks may induce the Chinese government to implement policies to draw down stocks more quickly. If this occurs, China's return to the status of a net cotton importer will be delayed

In Summary

The new U.S. – China agreement appears to offer long-term benefits to the U.S. and Arizona cotton growers. China's past policy distorted cotton production and restricted cotton imports. More open trade should strengthen China's textile sector and increase cotton imports. Growth of its own textile industry will divert cotton from exports out of China. China's huge and growing population, and especially its rising per capita income, will increase the demand of its textile industry for cotton imports. Under the agreement, the United States would eliminate its quotas on Chinese textile imports, and China would eliminate its quotas and reduce its tariffs on cotton imports from the United States and reduce other barriers to cotton trade. Part of the new trade agreement promises U.S. support for China's entry into the World Trade Organization – a move that should strengthen and expand the gains to cotton trade expected through the bilateral agreement.

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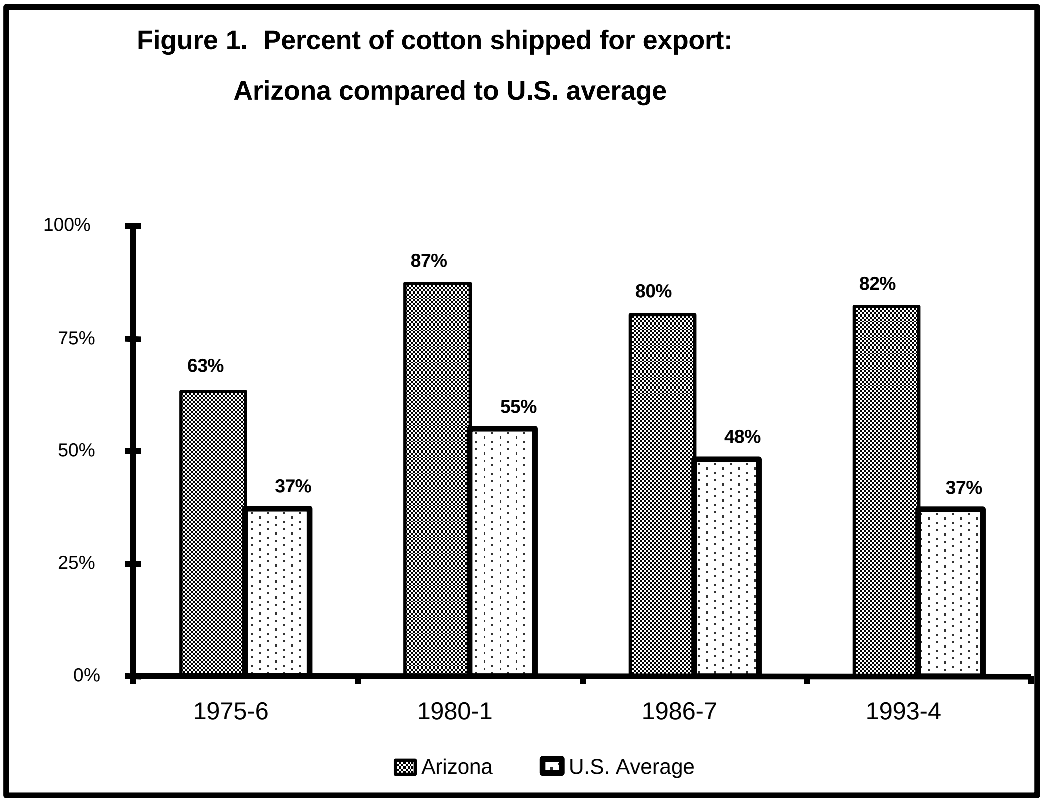
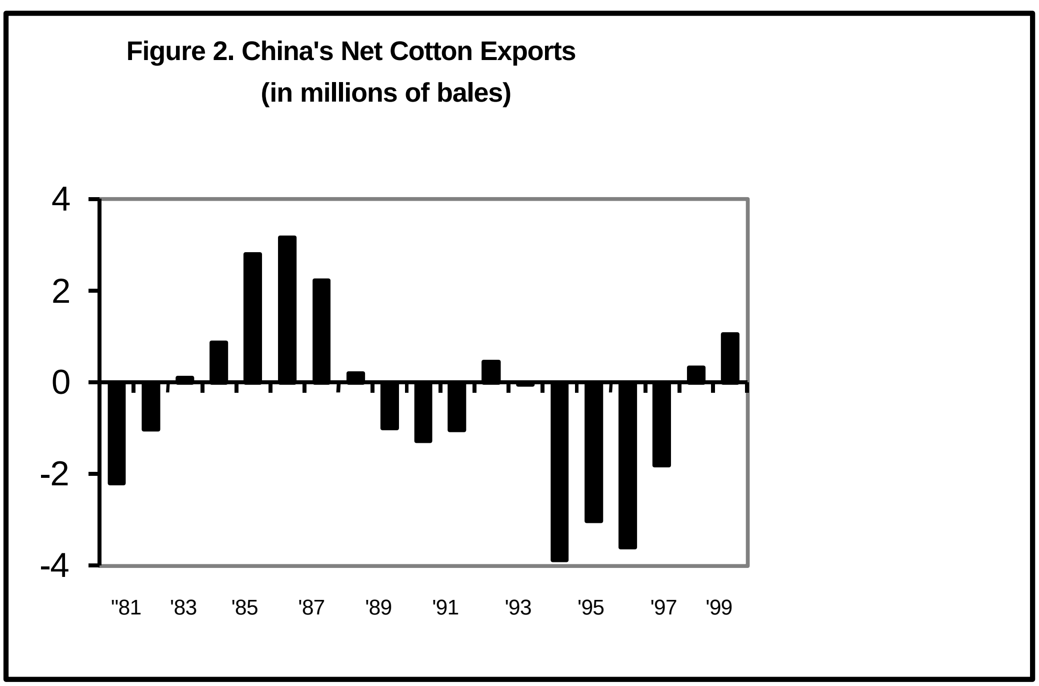


Source: Glade, Johnson, and Meyer, 1997 and Glade, and Johnson, 1988.



Source: USDA