

China as a Member of the WTO: Some Political and Social Questions

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China's entry into WTO in late-2001 will be as important to its development in the Twenty-first century as the victory of the Chinese Communist Party in 1949 was to the Twentieth. Entry builds on the extraordinary economic integration into the world economy that has taken place since reforms began in 1978 and shows China's leaders' commitment to being an active member of the world economic community. At the same time, it presents new challenges for the leadership in terms of the level of foreign presence China is willing to tolerate and how destabilizing this presence will be to native industry. In addition, it raises fundamental questions about national sovereignty and the extent to which crucial decisions about China's future development will be dictated or determined by factors beyond the control of Zhongnanhai.

Having negotiated entry terms for almost 15 years, the debate is only just beginning in China about what the real effects will be. Essentially, President Jiang Zemin and Premier Zhu Rongji realized that guiding the necessary concessions through China's complex bureaucracy would only result in delay and potentially strong opposition. As a result they took the whole process out of the political system and kept information within a tight, leading group. Now that entry has been assured and the details of the agreement are being disseminated in China, its people and bureaucracies are becoming aware of what they have signed on to and how it will affect their lives. Judgment is mixed depending on where one sits and how one views the impact.

Certainly the agreements are dramatic. It opens up new sectors, such as telecommunications, to foreign companies that will be able to own up to 50 percent of joint ventures (not the 51 percent offered by premier Zhu in April 1999). Tariffs, which had been among the highest in the world in the early 1990s, will be reduced dramatically with those on cars falling from 80 to 100 percent to 25 percent by 2006, agricultural tariffs will come down

from 31 to 17.5 percent and 14 percent for US priority products, and will be eliminated for computers, telecommunications' equipment and semiconductors. This should have the positive impact of reducing the rampant smuggling and corruption that has accompanied China's high tariff barriers. There have been equally dramatic agreements for the financial and insurance sectors. China has agreed to full foreign access for US banks within five years. After two years foreign banks will be allowed to conduct local currency business with Chinese firms and this would be extended to individuals three years later. Currently, foreign banks are not allowed to conduct foreign currency business with Chinese clients (corporate or individual) and severe restrictions are applied geographically on the establishment of foreign banks.

Realization of the consequences of these agreements have caused some to raise alarmist scenarios of increasing unemployment, greater inequality, Chinese firms going under because of lack of competitiveness, and many being driven off the land because of lower and better quality agricultural imports. However, much of the alarmist literature overestimates the problems and attributes to WTO effects that are the result of the shortcomings of the old system. In this short piece, I shall look at two issues. First, given the opposition and the potential short-term dislocation why did China's senior leaders decide to pursue entry so vigorously at this time. Second, what are some of the key social and political consequences likely to be?

The Imperative to Join

So why did China agree to such a tough set of conditions, what does it hope to gain from entry, and how will it set off potential gains against costs? I would identify five principle reasons why China wanted to join at the present time. First and foremost, China had very little choice as not entering might have afforded protection over the short term for its

economy but would have shut it out from the significant and structural benefits that would accompany membership. For example, if China were outside of the WTO it would more easily fall prey to unilateral sanctions for not just economic but also its political behavior. China's leaders had been shocked by the post-1989 burst of Western sanctions and have seen the US propensity to threaten sanctions against other regimes in the world that it does not like or that do not follow its policy lead. Also, although the multi-fiber agreement was a separate issue and China was protected until 2008, if it was not in the WTO it feared that it might become the target of textile quotas from a number of Western nations who would not be able to apply them to countries within the WTO.

Second, China's desire to be an important player on the world stage means that it must be a member of key organizations to influence policy-making. Simply being outside was not acceptable and would not have fit with Jiang Zemin's desire to project an image of an important country that needs to be consulted on major world affairs. Importantly, if China did not gain early entry, a number of decisions would be made that would affect its vital interests without it having any input. For example, trade in services and agriculture are looming issues, as are the questions of workers' rights and environmental protection. On the first two, China has a strong economic interest in being part of the debate, whereas China does not feel that the latter should be a part of the WTO discussions. It needed to join before crucial decisions were made on such issues.

Third, a number of senior leaders seem to have concluded that without some strong external disciplining mechanism, economic reforms might grind to a halt as vested interests resisted further forward momentum. In essence there is nothing in the WTO agreement that does not support the leadership's stated desire to move toward a market

economy and especially on the SOEs and the financial system there will be pressure for more fundamental reform. It is always useful for a politician to have someone else to blame for tough decisions and in the case of China who better than the foreigners? As Woo has argued if growth in China has come predominantly from institutional convergence to a prototype economy rather than from its exceptionalism during the transition, then entry can only be of benefit to sustained long-term growth.¹ Entry into the WTO will provide a line in the sand of reform that it will be almost impossible to retreat behind. It will bind subsequent leaderships to continuing economic reforms and increased internationalization of China's economy.

Fourth, WTO entry will bring a number of specific economic benefits to China. With Chinese economic growth slowing during the late-1990s and the state investment programs showing limited signs of success at best, it is clear that new sources of growth must be found. A number of Chinese economists have suggested that WTO entry could add as much as two percentage points to growth, enough to add 10 to 15 million jobs. In particular, WTO entry would improve market access for Chinese goods to major markets in Europe, Japan, and the US, especially for textiles and fashion apparel, and telecommunications equipment. Further, Foreign Direct Investment (FDI) growth has not only slowed but in 1999 it actually fell. WTO entry is seen as a way to sustain FDI and to encourage more US and European investment to supplement Hong Kong, other Asian capital, and Mainland China 'round-trip' capital. In particular, China wishes to direct more FDI to develop the service sector that must expand significantly for China to be able to absorb the surplus rural labor and laid-off industrial workers. One unintended

¹ See Wing Thye Woo, 'Recent Claims of China's Economic Exceptionalism: Reflections Inspired by WTO Accession', Working Paper No. 70, June 2001, Center for International Development at Harvard University.

effect may be increased foreign control over the private sector, which has been starved of funds because of official bias in investment policy that still favors the state-owned sector. If Beijing continues to prop up and privilege a moribund SOE sector, it may find that foreigners are funding and reaping the benefits from the fastest-growing sector of the economy.

Fifth, and far more speculatively, China may have seen some advantage in membership in terms of its political and increasingly strong economic relationship with Taiwan. WTO membership for both will increase trade and investment across the Straits and may give more impetus to restart talks on future political integration. Failing all else, the WTO will provide a mechanism for dispute resolution on economic issues between Beijing and Taipei.

Social and Political Consequences

As noted above a number of writers have begun to produce doomsday scenarios about the social and political unrest that WTO membership will bring to China. By contrast, a number of liberal intellectuals have welcomed WTO entry as providing an impetus not only to the further development of the market economy but also to a more rule bound and democratic political order.² WTO membership seems to presume not only a liberal trading order but also an independent legal system that constrains government as necessary, transparency, accountability, and a relatively pluralistic political order. However, this is likely to take a long time to develop. In essence WTO entry is liable to continue trends that had been set in motion well before China joined the WTO. In this sense, it will rationalize and hasten the

² See, for example, Liu Junning, 'Zhongguo jiaru WTO de zhngzhi yiyi [The Political Significance of China's Entry into WTO], presentation to the Fairbank Center, 2001. For a more pessimistic scenario see Shaoguang Wang, 'The Social and Political Implications of China's WTO Membership', *Journal of Contemporary China*, No. 9, 2000, pp. 373-405. For an excellent review of these issues see Joseph Fewsmith, 'The Political and Social Implications of China's Accession to the WTO', *The China Quarterly*, No. 167, 2001, pp. 573-91.

demise of the old economic order and will privilege those newly emerging sectors of the economy in which China enjoys an international comparative advantage.

In the space available I cannot cover all the social and political consequences and here will just concentrate of the important question of inequality, employment and rural labor. These are clear areas where the reforms have already set in train certain forces that will be carried forward by WTO entry. To date, the FDI concentration has exacerbated regional inequalities with greater wealth concentration in the coastal areas in the East.³ In 1998, Guangdong alone received 26.5 percent of FDI, the three major municipalities of Shanghai, Beijing and Tianjin received 17.5 percent and Jiangsu province 14.6 percent. By contrast, the nine provinces and one municipality in the Northwest and Southwest of China only received three percent of all FDI. This results in differential per capita rural and urban income. In urban areas real income was consistently higher with Shanghai enjoying real income approximately twice that of the Northwest and 60 percent higher than that in the Southwest. While the annual growth in per capita rural income from 1988 to 1995 averaged 4.71 percent for China as a whole, it was 11.66 percent for Jiangsu, 9.33 percent for Beijing and 7.11 percent for Guangdong. In the Southwest it was only 0.72 percent for Guizhou and 0.62 percent for Sichuan and 1.26 percent for Yunnan. As a result the average 1998 rural income for the coastal areas was about twice that of the Southwest, Shanghai was three times higher.

The differing levels of education, resource endowment and skilled labor force will mean that with WTO entry those areas already privileged will continue to advance disproportionately. The inland areas will have to hope that proponents of ‘trickle down theory’ are correct. The politically motivated ‘develop the West’ program will probably not

³ For more details see Tony Saich, ‘Globalization, Governance, and the Authoritarian State: China’, in Joseph S. Nye and John D. Donahue (eds.), *Governance in a Globalizing World* (Washington DC: Brookings Institution Press, 2000), pp. 208-28.

help greatly. It may even exacerbate the problems of transition if the funds are used to protect and prop up ailing enterprises and to continue subsidies that prevent necessary restructuring. However, WTO entry will also increase the existing inequalities in the Coastal areas and will contribute over the short to medium-term to an increase in the lay-offs from inefficient state owned enterprises. It is unlikely that new jobs can be created quickly enough to accommodate those already and about to be laid off in this sector. Angang Hu has calculated a real unemployment figure for urban China of around 17 million in 2000 with an annual growth rate of 16 percent.⁴ Those from the state-owned sector form a disproportionate amount of this total, about 69.6 percent of those laid-off in 1999. Not surprisingly, the Northeast is the worst affected with Liaoning (11.8), Jilin (10.2) and Heilongjiang (10) all with a real unemployment rate of 10 percent or higher. Chongqing, home to much heavy and manufacturing industry, was not far behind at just under 10 percent.

The Northeast is also the area that is likely to be most adversely affected by the impact on the agricultural sector. While parts of China may gain through agricultural diversification to produce fruit, horticultural products or meat, areas that are over dependent on grain production will suffer. The WTO agreement will mean that China will import much cheaper and better quality grains for both human consumption and animal fodder and this will cause rural incomes to decline even further. Poverty in rural China is closely linked to an exclusive reliance on agricultural production, especially grain, for income. Migration has been the only route out for many.

Already the pressures have led to an increase in the level of protest and even violence in rural areas. Whether the unrest will increase to such a level that it can threaten

⁴ Angang Hu, 'Creative Destruction of Restructuring: China's Urban Unemployment and Social Security (1993-2000)', unpublished manuscript.

political stability is difficult to predict but it clearly needs to be considered carefully by the political leadership in Beijing. Lifting restrictions on the non-state sector of the economy would be beneficial and directing funding away from loss-making SOEs would also alleviate the problems. There will be job growth with entry into the WTO but the Chinese government will have to do more to free the labor market so that those in rural China can move more easily to take up the new employment opportunities that will arise.

The challenges to the political and legal system are also great. The CCP is confronted by how to accommodate the social forces that will benefit from further globalization while disentangling itself from elements of the traditional power base. These trends are not the product of globalization, indeed domestic policy has been the prime cause, but globalization will exacerbate them and WTO entry will speed up the process. To head off dissent and to deal with the social cleavages that will increase with WTO entry China will have to develop more participatory and open mechanisms for political resolution and slowly will have to allow the political market place to develop to accompany the economic one. This will not be easy for the CCP leadership to accept. They seem to equate democratization with chaos and chaos with underdevelopment.

To deal with the regularization of its domestic economy and its engagement with international capital and trade, China has undertaken one of the most extensive crash programs in the history of legal development. However, as most foreign investors would attest, inadequate implementation, lack of transparency (especially with internal regulations that foreigners are not meant to see), and a tangle of local administrative regulations, detract from the effectiveness of the system. WTO entry will deepen the process of regulatory design for international trade but also will have a broader impact on the functioning of the domestic legal system. The major challenge confronting the CCP will be to accept that

membership presumes that disputes will be resolved by an independent rules-based supra-national body rather than by party-fiat or through the mediation of local political connections. Within China, pressure will mount for a more independent judiciary to adjudicate on economic issues and for greater transparency on transactions. This runs counter to current practice and will be hard to change. The practice noted above of internal regulations that foreigners are not allowed to see but that govern transactions will have to be stopped. An even bigger challenge will be to enforce laws and regulations passed at the national level. While such laws and regulations may represent policy intent, they are contravened and often undermined by a myriad of ministerial regulations and locally generated rules that provide the real operating context for activities. As the saying of local officials goes “they have their policies and we have our countermeasures” (*tamen you zhengce, women you duice*). Even if Beijing wishes to, it may not be able to ensure compliance by non-central authorities to WTO regulations.

Concluding Comments

While it is clear that China as a whole will benefit from WTO entry and that over the longer term benefits could be considerable, it is also clear that there will be losers and the pain in the short-term could be considerable. As Joseph Fewsmith has astutely observed the costs of entry such as unemployment, strikes and rural unrest, are concentrated and visible while the benefits, such as a more efficient economy, cheaper consumer goods and better governance, are diffuse and not visible.⁵ The challenge for the CCP is going to be how to balance the external pressures for moving ahead with concerns that moving too swiftly might bring about internal disorder. Too slow progress will be unacceptable to the US. In fact China has agreed to implement the agreements in a stunningly short period of time that can only have

⁵ Fewsmith, p. 589.

been agreed to because of extreme US pressure. China is too big and too political for the US to ignore and thus may not be allowed sufficient time for proper assimilation. One hopes that cool heads will prevail and that China will not be taken to a WTO tribunal for each and every insignificant infraction. There needs to be political maturity in this process.

The last factor is the whole question of the capacity and the durability of the WTO itself. It remains to be seen whether the US has the political will to keep participating nations focused on the agenda of the WTO and not to let it degenerate into a squabbling group of nations all pursuing individual national interests. The US itself will have to behave responsibly and abide by international agreements not all of which will be to its liking. To date, this has not been a strong point with the US. Should the US lose interest in the WTO then it will be open to all to interpret its framework in their own interests and China will be afforded much greater room for maneuver.