



## Dialogue on Globalization

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### China one year after joining the WTO

Bernd Reddies / FES Beijing – March 2003

#### ***China's government is taking advantage of WTO membership to increase the pace of reform***

Prime Minister Zhu Rongji achieved a major political goal in his reform-minded term of office when China was made a member of the WTO in November 2001 at the Doha conference. Negotiations to bring about Chinese membership in the WTO had been dragging along since 1985. Then the National People's Congress (NPC) appointed Zhu Rongji, who was known to be a pro-reform politician, as Prime Minister. He picked up the pace of what had until then been a policy of gradual economic and political reform, seizing upon the policy of opening up China and the prospects of China's joining the WTO to redouble pressure for reform in the country. China's joining the WTO confirms yet again that it has arrived in, and been accepted by, the club of major powers.

The U.S. and Europe believed that it was necessary to include China in the WTO due to its growing economic power and the importance of the country in international politics. Without China the WTO could not claim to be a trade organization of the most important industrialized countries in the world. And following the collapse of the 'New Economy', countries shaken by the Asian crisis hoped to export their way out of trouble with the aid of China's enormous market, thus helping pave the way for China's inclusion in the WTO regime as a 'new global customer'.

The profound impact Chinese membership in the WTO will have on China's future socio-economic development can only be compared with the launch of Deng Xiaoping's policy of reform and opening in 1978. Membership in the WTO concludes the first stage of reforms, consolidating all that has been attained to date and rendering the economic and political reforms carried out in China thus far essentially irreversible. By joining the WTO, China has accepted international norms and standards. The separation of state and economy will also open up China's political system to more participation.

The new government which was appointed by the NPC in March 2003 will follow in the footsteps of its predecessor in terms of the basic focus on reform policy and opening up the country to market economy forces. It is conceivable that minor shifts in emphasis will take place. For instance, it is possible that the new government will place a greater emphasis on labor market policy and social policy elements in order to steady geographic and social development in the country and ease the scissors movement threatening the social fabric.

When he took over as General Secretary of the CPC in 1989, General Secretary Jiang Zemin directed the Communist Party of China to initiate a sweeping modernization effort, which subsequently turned out to be much more all-embracing than other countries and even the Chinese themselves expected.

The NPC placed a new generation of trained political pragmatists and economic reformers elected to lead the country into the future at the 16<sup>th</sup> Party Congress (in November 2002) in key central government positions in March 2003. Equally important to the political consolidation of reforms has been the quiet replacement of the old party and government elite with younger office-holders at the provincial level as well as in the major cities over the past two years. This is to be followed by a fundamental reform of the entire public bureaucracy in China in the next five years.

### ***The balance sheet to date: stunning economic success***

In the year since it joined the WTO, China has turned in a spectacular economic performance. GNP has rocketed by 8% once again. Foreign trade has surged 20% at a time of global economic uncertainty (with exports totaling \$ 325 billion and imports \$ 295 billion). With an FDI of \$ 52 billion, China has surpassed the U.S. for the first time as the most attractive country for investment in the world. Currency reserves have swelled to \$ 286 billion in 2003. The Renminbi has been kept stable vis-à-vis the U.S. dollar in a controlled float – currency experts estimate a 15% revaluation potential.

The rest of the world has gazed upon the achievements of 2002 with a certain degree of awe mingled with increasing unease. The first murmurs can be heard in the industrialized countries to the effect that China's aggressive export policy in the consumer goods sector is also responsible for the increasingly deflationary tendencies to be seen in the industrialized countries. On the other hand, trading partners in the industrialized countries have seen their expectations of a Chinese market able to take on more imports after joining the WTO at least initially confirmed. Joint ventures were able to report mounting profits to their company headquarters in 2002. But the developing and newly industrialized countries fear that China will soak up global investment in the wage-intensive sector, jeopardizing the development plans especially of its Asian neighbors.

The Chinese government also attributes the continued success of its economic policy in the last few

years to stronger trust and confidence of the rest of the world in the stability and reliability of China as a new member of the WTO. China can now claim that liberalization measures have been instituted in the area of international trade and investment policy, as it pledged to do upon joining the WTO. A lot remains to be done. Changes in laws and new regulations must be implemented by a bureaucratic apparatus which is in part poorly qualified, and which has also shown a certain tendency to drag its feet. The entire legal system needs to be placed on a statutory footing and a specified set of sanctions set out in legal codes. The government apparatus and the economy continue to be plagued by corruption. But in sum the international political arena and investors have confirmed their confidence in the government's sustained efforts to fulfill WTO obligations.

### ***Domestic political factors***

Other countries have to a large degree overlooked the spectrum of domestic political factors motivating China's government to carry through with a sustained reform policy to join the WTO. The privatization of enterprises owned by local and provincial governments was for the most part completed by the end of the 90s; this process was beset with many obstacles and the occasional scandal, but was sweeping in its scope. What remained in the hands of the central government were some big state enterprises and their source of financing, the four major government banks. In lieu of any restructuring of these state enterprises, which are not without political influence, it will be impossible to strike out in a new direction and liberalize the banking industry. Prospects of a speedy inclusion in the WTO were used by the government to bully those attempting to slow down reforms, arguing that anyone failing to seize the opportunity to align with market forces would go down at the latest when the liberalized international competition of the WTO regime takes hold. The government subsequently abandoned its micro-planning of the economy, dismantling the Central Planning Commission and the ministries in charge of economic sectors. To support the accelerated structural changes and provide a social cushion, the central government has been employing Keynesian macro-economic tools and an active fiscal

policy of deficit spending since 1998. In spite of this it has been successful in keeping the annual government deficit below the 3% Maastricht limit.

One nightmare haunting the government is the unavoidable prospect of debt-reduction followed by recapitalization of the banking industry. To overcome the financial and structural crisis faced by the four major state bank institutes, the central government will ultimately have no choice other than to treat non-paid loans (NPL) to state enterprises more or less as government debts and list these as subsidies in the government budget. All efforts to attain a reasonable pay-back rate by using asset management companies (AMC) have thus far only showed modest success. The NPLs and AMCs of the four state banks add up to 40% of GDP. In view of this enormous burden on the budget, the only consolation is that the NPLs do not constitute an external risk. (The Asian financial crisis in 1997-8 was for the most part due to the withdrawal of short-term investments by foreign investors.) A liberalization of financial markets and thus an opening to foreign investors cannot be commenced with on a large scale until the state banks have been restructured and recapitalized.

One important domestic political aspect of China's WTO membership has gone largely unnoticed by other countries. WTO membership has allowed the central government to stage an assault on a historically evolved politico-economic anachronism in the country. Even during the period of reforms the country's provinces treated each other like independent fiefdoms in the area of trade and investment. The provinces have traditionally protected their economies against unwanted competitors or potential investors from other provinces by means of local tariff and non-tariff barriers to trade. In joining the WTO, China has assumed the responsibility to institute free trade. This gives the central government a reason to obtain compliance for a clear national policy towards domestic trade right down to the local level. Thus a cabinet directive was issued in April 2002 prohibiting regional barriers to market activities. The 1994 Foreign Trade Act is also being revised at present. Under the WTO regime the central government views its task to be the establishment of fair, orderly competition and to protect do-

mestic enterprises against discrimination in foreign trade. Hence the central government has been able to secure a degree of control over domestic trade previously unknown in Chinese history by virtue of its WTO membership. Zhu Rongji is setting out to create a liberalized, unified domestic market by applying the lever of WTO membership. The central government will then bring this revolutionary step to its culmination by instituting the planned liberalization measures with the aid of the new political elite which has been appointed in the provinces.

### ***Consequences for agriculture***

China realizes that the WTO regime will mean draconian cut-backs in subsidies for the important agricultural sector. More than 700 million people still live from agriculture, for the most part eking out an existence on small, uncompetitive plots of land. China is still a net exporter in the agricultural sector. But to the general surprise of other WTO members, China is fairly amenable to a step-by-step liberalization of imports in the agricultural sector. China even underscores – together with the U.S. – its desire to eliminate protective tariffs in the agricultural sector, even though this liberalization will mean mounting unemployment and underemployment in China's agricultural sector. The government is responding to this by instituting a policy of targeted urbanization. It cannot be ruled out, however, that intensified internal migration will lead to increasing numbers of migrants ratcheting up urban unemployment in many regions.

### ***Positive prospects across the board***

In sum total the Chinese government views WTO membership to offer excellent prospects along a broad front. China has been granted the transitional period usually afforded to developing countries to liberalize trade and eliminate protective tariffs. And China believes that its economy will profit by relying on its strengths and the opportunities held out by WTO membership. So when other developing countries point out that the WTO regime primarily serves the interests of the rich countries and their multinational corporations, China rejoins that the liberalization of international trade offered by WTO membership will allow it to create a competition-

based domestic market with a liberalized management system.

In the accountability report submitted by General Secretary Jiang Zemin at the 16<sup>th</sup> Party Congress of the Chinese Communist Party, the passage relating to foreign cooperation with the Third World only warranted mention in 3<sup>rd</sup> place – after improved

relations with the developed countries and good relations with regional neighbors. Looking back on earlier speeches setting out basic principles, it is evident that priorities have changed.

China has indeed come a long way from the Third World Bandung Conference in 1955 to the WTO Doha Conference in 2001.

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*In the run up to Cancun, Focus on WTO contributes – through conferences, workshops and publications – to the international debate on the Doha development round. It is part of the international work of the Friedrich-Ebert-Stiftung. For further information please contact:*

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