1. A Globalizing China: An Introduction

Shang-Jin Wei, Guanzhong James Wen and Huizhong Zhou

The continued advance of the world economy demonstrates convincingly that international trade and economic integration bring greater wealth and welfare to all participating nations. However, these potential gains are not distributed evenly among different interest groups within each nation. There will be winners and losers at least in the short run. Disruption and commotion resulting from economic integration can be costly and painful when a nation makes adjustments in its economic and social structure. Therefore there is also resentment and resistance to globalization. The redistribution of costs and benefits, if not handled properly, can lead to social instability and international conflicts. Indeed the earlier rounds of economic globalization witnessed disruptions and delays in some extreme forms such as the World Wars and the Cold War. Therefore a nation that embraces economic globalization must be ready for social reforms and economic restructuring and adapt itself to uncertain developments of globalization before it can fully benefit from it.

China's long struggle for openness and economic integration, which has eventually led to its accession to the WTO recently, will prove to be an excellent example that demonstrates the distrust and resistance that a nation may hold against globalization, the benefits that it will enjoy through integration and the pain that it can suffer when exposed to world competition. Although China has made every effort to integrate itself into the world economy in the past two decades, it has a long history of closing its door to outsiders. Inheriting a great civilization that has its own values and traditions China had often looked at the rest of the world with suspicion. Its record on international integration was rather poor in its modern history. For example, before 1840, when the first Opium War forced China to open its door, China led almost all East Asian nations in following a sakoku policy that closed national borders to foreigners. As recently as the mid 1960s through the mid 1970s the Chinese leaders openly challenged the rationale underlying economic globalization by overemphasizing so-called self-reliance and nearly discontinuing trade with a limited number of partners that it kept during that period of time. Moving from being hostile to economic globalization China now becomes a constructive force, whose stake in preserving and promoting the existing global rules and order will grow as its trade with the rest of the world expands. The experiences of this transformation in China should...
provide important lessons to those economies that are facing difficult choices as to whether and how they should open their doors to the world.

The significance of China's accession to the WTO lies also in the size and potential of the Chinese economy. China used to choose to stay away from the world's efforts in enhancing exchange and cooperation in the past. Its participation in the WTO marks a new era in which all the major powers join forces for the first time to promote economic integration through free trade and market competition. Thus it is now more promising than ever that the current round of economic globalization will be sustained. China's decision to become a member of the WTO has far-reaching implications both for China itself and for the rest of the world. It signifies that China is to break away from its past practices of managed opening and controlled trade, which have become increasingly unacceptable to China's major trade partners. By accepting the rules and regulations of the WTO, China has committed itself to opening further its market and leveling most of its trade and investment barriers within two to five years. China has promised to allow foreign capital to enter gradually the sectors that it has been protecting so far, such as heavy industries, agriculture, finance and retail. These measures will surely bring tremendous benefits to the rest of the world as well as China. The significance of China's embrace of the WTO can never be overestimated. This event may be remembered as one of the most important in this century.

Given the importance of China's membership of the WTO and diverging opinions regarding the benefits and costs of China's accession to the WTO among policy makers, business practitioners and economists in China and abroad, it is high time for a dispassionate, balanced and fact-based analysis of the implications of China's accession to the WTO. This volume serves exactly that purpose. The volume is based on research papers presented at an international conference, 'Developing through Globalization: China's Opportunities and Challenges in the New Century,' held in Shanghai, 5–7 July 2000. The conference was sponsored by the Chinese Economists Society, a US-based non-profit research organization. Most authors in this volume are professors and research scholars at universities and institutions in the United States. All have an intimate knowledge of the Chinese economy and society and follow closely new developments in the country. Many of them were born and grew up in China. They share a unique combination of an outsider's broad perspective and an insider's sensitivity to details and subtleties. The analyses in this volume are intended to promote a more complete understanding of the implications of China's WTO membership for itself and the rest of the world while offering timely policy recommendations to China and its trade partners.

China's accession to the WTO will have profound impacts on the Chinese and world economies. Since 1978 China has been an important player in the global economy. By the end of 2000 China's exports were worth $249.2
billion and its imports reached $225.1 billion. By joining the WTO China will be committed to adopt measures to liberalize trade further, including substantial reductions in tariffs and non-tariff barriers in many sectors. New opportunities for export and the expected influx of foreign goods will change and inflict profound effects on the structure of the Chinese economy. The industries that face the greatest challenges are those that are regarded as strategically important to the national economy and security, such as telecommunications, banking and financial services, and automobiles and energy. They have been monopolized by the central government and protected from competition until very recently. The challenges faced by these industries are twofold: Not only will enterprises have to improve their performance to compete with foreign companies and possibly domestic non-state rivals, but regulators or policy makers will also have to revise the rules of the game such that these conform with the WTO agreements. The chapter in this volume on industrial policy provides an overall account of the regulatory environment in which Chinese enterprises have been operating and in which foreign competitors may find themselves when they enter the Chinese market. Chapters on telecommunications and the automobile industry offer particular cases of regulated industries and changes taking place recently. Some of the conclusions derived from the analysis of these two industries can be extended to other highly regulated industries in China.

Another major impact that China’s WTO membership will bring to the economy is the displacement of the labor force, especially in the agricultural sector. The rural labor force has undergone dramatic restructuring during the past two decades when the Chinese economy grew and developed rapidly. Large-scale migration from rural to urban areas has brought troubles to cities as well as cheap labor and prosperity. Moreover urban areas have their own unemployment pressure. The state sectors employ about one half of China’s urban employees. Although state-owned enterprises have been improving their performance in the face of competition, they still lag behind non-state firms and many are on the brink of bankruptcy. The governments have started to dissolve failing state enterprises recently. With increased competition as a result of WTO accession one can only expect massive layoffs in the state sectors. As China’s social safety net is still under construction, large-scale unemployment and displacement can cause disruptions to society. Job creation, urbanization and social security will become the center of concerns for economists and policy makers for years to come.

The membership of the WTO will bring in valuable resources to China, in particular, badly needed capital. China has already benefited greatly from foreign investment since it opened its door to the world economy in the late 1970s. It has become the largest recipient of foreign direct investment (FDI) among developing countries since 1993, receiving over $27 billion in that year, which amounted to 35 per cent of total FDI in all developing countries.
Toward the end of 2000 the cumulative number of registered FDI projects stood at 361,500, the contracted value of FDI was $662.6 billion, and the total realized amount of FDI in China reached $344.1 billion. The inflow of foreign capital has created employment opportunities and contributed to the growth of the economy. FDI firms employed 18 million Chinese by the end of 1996, constituting 18 per cent of the total non-agricultural labor force. In 1997 19 per cent of total gross industrial output was produced by foreign affiliates. China’s accession to the WTO will open the door further to foreign investors, which should benefit the Chinese economy even more.

With the accounts in the previous paragraphs as the backdrop, we organize the chapters in this volume into three parts: Part 1 provides updated accounts of recent developments in several important sectors in China, including agriculture, telecommunications and automobiles. These new developments should prove useful to policy makers and investors seeking to evaluate market conditions in traditionally regulated industries in China. The first chapter in this part offers an overview of industrial policies in China. Chapter 3 evaluates the effects of China’s accession to the WTO on its agricultural sector and offers an overview of the outlook for the rural economy in the future. Chapter 4 provides a comprehensive account of the rapid growth and profound changes in telecommunications in the past 15 years or so, and Chapter 5 assesses the implications of major adjustments in the telecommunications rate structure that took effect in 2001. While both addressing regulation and competition in the telecommunications industry, the latter is more critical of regulatory arrangements of the industry than the former. The conflicting views reflect the fact that, while making great progress in opening the market for competition, the industry is still highly regulated. Chapter 6 offers a projection of the potential demand for automobiles and automobile fuel in China and evaluates the impact of the WTO on the Chinese automobile industry.

The second part of this volume addresses some of the concerns in China regarding its entry to the WTO, which include whether the opening of the Chinese economy will cause massive unemployment and increase inequalities among regions. Chapter 7, using a computable general equilibrium model, analyzes gains and losses in jobs as a result of China’s entry into the WTO, while Chapter 8 examines the impact of globalization on regional inequality and identifies factors that mitigate inequalities among regions. Chapter 9 addresses a related issue, namely, migration and urbanization in China in the midst of globalization.

Part 3 evaluates the effects of increased trade and financial ties between China and the rest of the world. The first two chapters in this part analyze the effects of China’s entry into the WTO on the US and Taiwan economies. They are followed by two chapters that investigate conditions facilitating foreign direct investment in China. Chapter 12 identifies factors in the host
country, China; while Chapter 13 examines characteristics of investing firms from different countries. The last chapter in this part provides an assessment of the outlook for trade disputes involving China in the near future as trade between China and the rest of the world grows.

The remainder of this introduction provides an overview of each chapter.

PART 1. TRANSFORMATION IN THE CHINESE ECONOMY

The Chinese government still plays a dominant role in the economy, although that role has declined steadily from the heyday of central planning during 1949–1979. While refusing to abandon intervention in the economy, the Chinese government has increasingly recognized the importance of moving towards rule-based intervention. In 1989 China promulgated its first industrial policy. The content of the policy has evolved over time. Some of these policy specifics are inconsistent with the requirements of the WTO and will have to be jettisoned. Others are likely to be modified and remain in effect even after WTO membership. In the first chapter in this part Lu provides a review of the evolution of China’s industrial policy and a timely assessment of what the business-government relationship is likely to be after entry into the WTO. China’s industrial policy favors certain sectors at the expense of others. Sectoral discrimination is often accompanied by unequal treatment of foreign and domestic firms. The current policy characterizes development projects as projects to be encouraged, projects to be restricted or prohibited, and projects to be left alone. Projects to be encouraged include those that bring in new technologies in agricultural development, technologies that save energy and raw materials, and production processes that contribute to exports and that can be located in the central and western regions of the country. Foreign firms that are able to take advantage of these industrial biases can expect to do relatively well in the post-WTO China. Lu’s chapter also offers information on sectors that are discouraged or prohibited, which is equally useful for understanding future foreign investment patterns in China.

Johnson’s chapter deals with the agricultural sector and the rural economy. He evaluates the short-term effects of WTO accession on China’s agriculture and emphasizes that economic growth, not just WTO entry, will bring about broader and more significant adjustments in the rural sector over the coming decades. Johnson points out that the much-talked-about crowding out of domestic wheat and other agricultural products by foreign products is only part of the picture. Chinese farmers will also benefit from more competitive markets for inputs—fertilizers, pesticides, seeds and machinery and improved access to credit. Compared to the adjustments in response to the WTO, the adjustments in China’s rural area required by its overall economic growth are
much more substantial. Johnson projects that agriculture’s share of national employment will decline from the current 45 per cent to about 10 per cent by 2030. This adjustment could take many forms. Instead of migration to industrial cities, which has been restricted by the central government, the employment of rural labor could take the form of non-farm jobs located in the rural areas, including the so-called township-village-enterprises, which have experienced rapid growth throughout the last two decades. Restrictions on renting and sale of land use rights and on rural–urban migration, or their lack thereof, are likely to have a significant impact on the welfare of the people currently in the rural areas.

Telecommunications is one of the few high profile areas in China’s entry negotiations with major WTO members. In Chapter 4 Lu provides a detailed account of the process of opening for competition in this industry. Amidst rapid growth in the past decade, dramatic measures have been taken to break state monopolization, including introducing competing operators, restructuring the dominant incumbent and separating regulatory functions from business operations. Some operations such as paging and messaging have become very competitive. Telecommunications equipment manufacturing was open for competition much earlier and is now very competitive in the global market. Major foreign equipment manufacturers have significant operations in China. However China currently prohibits foreign equity investment in telecommunications operations. When it becomes a member of the WTO, China will allow foreign firms to have up to 49 per cent ownership in telecommunications.

Zhou is more critical of the competitive conditions in the Chinese telecommunications market. He characterizes the market as one controlled by a captive regulator and a dominant incumbent. Although political competition has introduced new players into the market, price control by the regulator and the dominance in access by the incumbent has impeded competition. Against this background Chapter 5 introduces the new rate structure that is to take effect in 2001 and evaluates its impacts on the market. Under the new structure, rates for most services are lowered, especially for line leases and Internet services. Cross-subsidization from long-distance to local telephone service will be reduced, while that from urban to rural areas may increase. Access and interconnection are still highly centralized. Overall these adjustments do not represent much progress in curtailing the incumbent’s market power and promoting competition.

The last chapter in this part offers an assessment of the prospects for cars and car fuel in China. The development of the automobile industry will not only boost other major industries, but also increase mobility and employment and change the life style of the people. It will also generate pollution and cause over-population and traffic congestion in urban areas. Yin and Gates offer a projection of the future demand for cars and car fuel in China based
on projected income growth and the experiences of other countries in acquiring cars. Various studies suggest that the number of cars in China in 2010 will be between 10 to 30 per 1000 people. They then discuss inefficiencies in the Chinese auto industry. Two major problems of the industry are the small scale of manufacturers and the fragmentation of the market. These problems are a result of special treatment of the auto firms by the central and local governments and regional protectionism. The chapter also evaluates the effects of China’s entry into the WTO on the industry and suggests how FDI can improve the efficiency of domestic auto manufacturers as well as benefit foreign producers.

PART 2. SOCIAL IMPLICATIONS

The prospect of imminent membership of the WTO has stirred up fear among many people inside China focusing on, among other things, the possibility of a sharp increase in the unemployment rate at least in the short run. The basic reason behind these concerns is the asymmetric responses to WTO entry from the Chinese import-competing sector and the export sector. The negotiations that led up WTO entry have committed China to take liberalization measures that will result in greater reductions in Chinese barriers to foreign products than in foreign barriers to Chinese exports. Consequently it seems reasonable to conclude that, within the next five years or so, there will be a greater increase in Chinese imports than exports, and a greater loss in jobs in the import-competing industries than gains in jobs from the export industries. Hence the aggregate unemployment rate will rise. This rise in unemployment could cause social and political instability, with which the Chinese government has been obsessed. In their chapter Li and Yang dispel this myth. With the aid of sector-level data and a computable general equilibrium model that relaxes the standard assumption of full employment, they demonstrate that the aforementioned concern is only partially right. It is true that the volume of imports may very well rise faster than the volume of exports. However the export sectors in China are generally more labor-intensive than its import-competing sectors: a 1 per cent increase in exports creates more jobs than jobs lost resulting from a 1 per cent increase in imports. Their model shows that, on a net basis, WTO entry will indeed create more jobs from increased exports than jobs lost to increased import competition.

Two additional elements may further alleviate fears for increased unemployment. First, if the real exchange rate is allowed to adjust, even the relative rate of growth of China’s imports over exports is likely to be adjusted downward, which may provide another boost to job creation. Second, the analysis in this chapter concentrates on the effects resulting from changes in exports and imports. WTO entry will also bring more foreign firms, banks and other businesses to China.
Another concern in China is whether globalization will increase income inequality among regions. This concern has as many political implications as economic ones. Zhang and Zhang examine this question in Chapter 8 using Chinese province-level data. They find that greater participation in international trade and a larger share in inward foreign direct investment are indeed correlated with a faster growth rate. This supports casual observations that China’s coastal areas are more open and grow faster. The authors offer two possible explanations: The first is comparative advantage. Coastal regions can better take advantage of the world economy and are in a better position to catch up with wealthy countries than are the inland provinces. The second has to do with government policies. By and large the government economic policies until recently have tended to favor the coastal areas. These policies include offering tax concessions and exercising liberal regulations in the so-called special economic zones and coastal open cities.

Dislocation of jobs and income inequality among regions has already created a massive wave of migration in China. A taxing task facing the government is how to approach urbanization. In his chapter Wen projects that urbanization in China will accelerate after WTO entry. The urban population may increase from 400 million, or a third of the current national population, to about 1.6 billion, or 80 per cent of the national population by the middle of this century. Wen’s projection implies a more sanguine view than Johnson’s on how quickly restrictions on rural–urban migration may be eased in China. If Wen is right, the speed of urbanization would be unprecedented in human history.

PART 3. LINKAGE WITH THE WORLD

With WTO membership China’s exports to the US and the rest of the world will increase, while its imports from the US and the rest of the world are likely to increase as well. What does this mean for employment and output in the US and China’s other major trading partners? This question can be properly answered with the aid of multi-sector models based on detailed data. Wang provides such an analysis with a computable general equilibrium model suited to this task. To make the analysis meaningful, he considers two scenarios: a world with China and Taiwan as members of the WTO adhering to liberalization measures agreed upon during the China’s WTO accession negotiations, and a baseline case in which China and Taiwan are not members. The overall message for the rest of the world is moderately positive: the real growth rate of consumption in the world would be 0.02 percentage points higher each year with China’s membership. The benefits are substantial when accumulated over time. For the United States real consumption would be 0.16 per cent higher by 2010 with China’s WTO membership. Overall, China still benefits more than other countries.
WTO membership brings a gradual phase out of the Multi-fiber Agreement quota imposed on apparel exports from China (and other countries) to the US. Wang's analysis suggests that China is in a better position to take advantage of this phase out than are its Asian and Latin American competitors. He projects a further rise in China's market share in the US market. His projection puts China's share in the US apparel market at 40 per cent by 2010, exceeding the shares of all other Asian exporters combined.

Taiwan has been a significant direct investor in Mainland China. The cumulative realized FDI was about $24 billion by the end of 1999. Trade between the two sides of the Taiwan Strait is also significant, reaching about US $26 billion in 1999, though often through a third region such as Hong Kong. Taiwan enjoyed a huge trade surplus in the order of $17 billion that year. Tung's chapter addresses several questions on the impact of the cross-strait exchange on Taiwan. For example does Taiwan's direct investment in China drain investment from Taiwan? Does trade between the two contribute to a change in wage inequality in Taiwan? Definitive answers to these questions are hard to come by due to data constraints. Tung suggests that investment in China has not drained investment from Taiwan in general. While moving some production activities to the Mainland may reduce jobs associated with these activities, lower production costs in the Mainland help to maintain the overall profits of firms and to expand jobs in the production that stays in Taiwan. There is no evidence either to support the view that Taiwan's investment in China has worsened wage inequality back home. In fact, during the period 1987-1996, when there was an acceleration of Taiwan's investment in China, there was an improvement in the ratio of earnings by non-college graduates to those of college graduates.

For the last two decades or so China has been the largest recipient of foreign direct investment (FDI) among developing countries. By the end of 1998 the total FDI in China reached $265 billion. In his chapter Zhang provides a systemic framework to analyze determinants of FDI and its economic impacts. He then explores factors behind China's success in attracting FDI to foster economic growth and development. These factors include the size of the Chinese market, policies toward FDI, a strong central government and a large body of overseas Chinese investors. The chapter also finds that patterns of human capital may affect the distribution of foreign investment among regions.

Chapter 13 analyzes factors that affect FDI strategies from the perspective of the investors. In this chapter Liu, Xu and Liu identify important characteristics of four groups of foreign firms, overseas Chinese, Japanese, European and American, and investigate how these characteristics affect each group's investment strategies. The study is based on a survey of 405 FDI firms in Guangdong province. The findings in the study should provide a
basis for assessing the effect of China’s WTO membership on inward investment from various sources.

As trade between China and the rest of the world grows, trade disputes will inevitably emerge. Yin and Lee’s chapter examines the prospect of trade disputes in detail. Based on historic data the authors establish a relationship between trade disputes that a country is expected to encounter and its various economic and policy characteristics. There is evidence that countries with large volumes of trade and high tariff and non-tariff barriers are more likely to be involved in disputes. Countries that export mainly primary products and products from heavy and chemical industries are less likely to have disputes, while exporters of other manufactured products such as textiles are more likely to be involved in disputes. The authors go one step further to make an estimate of the likely number of trade disputes that China may face as a member of the WTO, based on the prediction of a model that is built on statistical data on China’s trade structure in 1997. This ‘educated guess’ suggests that China would encounter 19 cases of disputes, placing it in fifth place among all nations on that score. One could speculate that trade disputes involving China might be even higher than this in the near future as China’s share in world trade rises. The authors also discuss challenges faced by China in practicing rules of law as demanded by the WTO and the implications of the newly available WTO dispute settlement mechanism for multinational firms operating in China.