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4. The Implications of China's Accession to WTO

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Abstract

China formally applied to rejoin the GATT in 1986. After more than ten years of negotiation, however, China's entry into WTO seems as remote as ever. This unprecedented long application time in the GATT/WTO history, coupled with the uniqueness of the China case and the rapid growth of the Chinese economy, has made this subject one of the heated topics in the IPE field. Many works have addressed the rules and principles of WTO and status quo of China's trade regime to imply a gap in between. By doing so, these works emphasize the insufficiency of China's progresses on reductions of tariff and non-tariff barriers, lack of transparency in its laws and regulations, and the lack of national treatment of foreign companies. These are the major issues on the negotiation table; however, little work has been done the goal of the Chinese economy, which is the reason behind its economic and trade policies and its reform on the regime. To some degree it will have deeper impacts on its policies than the nature of its economy does. Because if China is simply during the transition from non-market economy to market economy, then we can make sure that economic liberation is under way. However, if today China's situation is a combination of a transitional economy and a nationalist economy, then we have to reconsider the whole framework.

By emphasizing the uniqueness of the China case as both a transitional economy and a nationalistic economy, I shall draw two main propositions from the following analysis. First, neither China nor WTO are ready for China's accession. Second, the WTO membership is crucial for China's further openness, but in the meantime, further liberalization is required of China, especially in the area where the role of the state is to be minimized. In the following sections of the paper, I shall first examine the current incompatibility between WTO, an important international economic institution, and China, a complicated unit to be incorporated. I shall then explore the uniqueness of the China case in an attempt to answer the question why

neither side is ready for China's accession at this time. In the end, I shall provide certain policy recommendations for both China and WTO on this matter.

The Current Systemic Friction between WTO and China

A commonly attributed reason that it is difficult for China to enter WTO is the systemic frictions between China's economic and political systems and the substantial principles and rules of GATT/WTO. In this case, the systemic friction refers to the degree of those incompatibilities that have difficulty to be compromised by both sides. By acceding to WTO, China would have to agree to abide by the four GATT cornerstones and all the rules designed to elaborate and buttress them. China would also have to agree to abide by Uruguay Round agreements on trade-related issues such as intellectual property rights. The following are the three factors that could have led to the systemic friction between China's political-economic system and WTO.

First, the nature of China's semi-market economy needs to be considered. Even though China has liberalized most of its economy, at least 35% of its gross domestic product is still produced by its state-owned enterprises. Actions by the state-owned enterprises have the potential to undermine all four cornerstones of the WTO system. For the most part, the GATT assumes that atomistic producers and consumers make the economic decisions based on price, but the state-owned enterprises do not always make decisions along the same line. GATT Article XVII was intended to discipline activities by state-owned enterprises; however, the draftsman could never have anticipated possible problems created by the accession of a country as big as China, and its economy with such a significant role of its state-owned enterprises. Consequently, GATT Article XVII was never designed to address issues in this area created by China's accession. The Chinese government has started its reform of the state-owned enterprises, however, the probability of success and the timetable are both open-ended questions.

Second, the WTO system assumes that its laws, regulations, and administrative and legislative processes for members are transparent. This is also crucial to the effectiveness of the GATT's main principles. In order to enjoy truly national treatment, foreign companies should know the rules of the game as well as the Chinese companies. However, the content of current laws and regulations of China are so ambiguous that gives authoritative interpretations of the Chinese side a lot of flexibility. With so many 'inner decisions', the transparency of process is almost non-

existence. Under the current system, it is impossible to achieve true non-discrimination. GATT Article X requires the publication of trade regulations prior to their applications, but this discipline is not broad and specific enough to cover all of the kinds of transparencies problems encountered in China since publication itself does not ensure anything.

Third, China lacks any meaningful policy concerning competition. WTO presumes all its members have such a policy as an implicit requirement for entry. In the meantime, purposeful protections by the Chinese government of certain state-owned enterprises and certain high-technological and strategic sectors are inevitable. Consequently, the confrontations between the request for fair competition from foreign companies doing businesses in China and the strong intention of Chinese government to protect its substantial sectors are also inevitable.

The above-identified issues, among others, comprise the systemic frictions between the WTO system and the Chinese political and economic sub-systems. Should China be granted the membership, it would be the only member of WTO whose political economy raises problems such as those identified above. This constitutes one important element, which can be characterized as the uniqueness of the China case.

Why Is China Unique?

The uniqueness is defined, for the purpose of this article, as the incomparability to other social units. The uniqueness of the China case would produce impacts unprecedented, and more seriously, unexpected, to WTO.

First, China is in a class of its own politically, characterized by a highly centralized and relatively closed government. An open and transparent political process enhances the predictability, stability, and effectiveness of the policies of the government, however, a fundamental change of the nature of the Chinese politics is impossible in the near future and also out of the demand of WTO. Although China is aiming to become a market economy, it has proceeded on a dual track, with transactions determined by the market forces and strategic policies that continue to be shaped by the central planners. The role of the state remains pervasive economically. The Chinese Communist Party, the initiator of the reform, will sooner or later become the obstacle for further liberalization. It is hard to find incentives for them to destroy their own legitimacy.

Secondly, decades of isolation has proved to be a handicap for China to interact with the rest of the world, coupled with the lack of a genuine understanding of the market and the rules required for it to function orderly. China has been slow in familiarizing itself with the rule-based, market-driven requirements of the multilateral trading system. Clearly, the Chinese authorities naively assumed that a show of good will to move towards a market economic system would suffice and assure its entry ticket into the GATT when it first applied in the 1980's with great confidence. China is learning gradually and painfully that although it may have good intentions, concrete results are needed as well.

The lack of understanding of how the westerners play the game can be easily demonstrated by the history of China's foreign policies. Before the 1840's, the Chinese view of the international relations could be referred to as the 'Chinese World Order'. It was hierarchical with China at center, instead of every nation being equal. After the West opened China's door with military power in the mid nineteenth century, China lost the chance to learn how to play the game because it was forced to accept whatever was laid in front of it by the Western countries. After the Socialist revolution, China went back to isolation and also the thinking of the 'great China' under Mao, to some degree. China did not change during the late cold war era because the US, its strategic player, encouraged or even 'helped' China to join UN, the World Bank and the IMF out of security considerations, without requiring China to make painful adjustments. To some degree, China's application to WTO is the first time when China is expected and required to accept the 'same standards' as required of other countries. On the other hand, China never developed enough understanding of this problem before its application. Consequently, the Chinese government took the step towards a WTO membership with great optimism, only to feel humiliated later on. This 'equal treatment' has significant impact on the reconstruction of the Chinese identity and its nationalism, as well as its foreign policy. However, it is doubtful that the 'equal treatment' would be completely feasible at this time in regards to China's accession to WTO, or that somewhat a 'special treatment' may still be necessary.

Thirdly, China's rapid economic growth has made it a visible target. China became the sixth largest exporter of goods in the world and seventh largest importer in 1995. In 1996, China shared with Hong Kong the rank of the fifth among the world's sixth largest trading economies, after the EU, the US, Japan and Canada. China is US's forth-largest trading partner and attracts

nearly \$50 billion in FDI each year, second only to the US. Today, about half of all the workers in the manufacturing industry of the developing countries are in China. Most consumers in OECD countries are now using products from China on a daily basis. China's prolific export performance has led to the fact that the interests of business and trade have fallen victim to the Western protectionist sentiments.

Fourthly, China is a non-uniform regime. It enjoys severe uneven development. Accession as a developing or a developed country has always been one of the major concerns of both sides. With its low per capita income (according to China's own calculations amounting to USD374 net per capita income in 1994 in urban areas and much less in rural areas), even with generous allowance for errors and increased income accounted over the past three years, China is qualified as a developing country. On the other hand, China is not ordinary developing country with its rankings as the world's third largest national economy. The Chinese coastal regions are on a par with the newly industrializing economies and some of its industries are highly competitive internationally. Barry Naughton classifies three primary regions rather than the two that are normally used: the relatively underdeveloped hinterland provinces, the dynamic southeast provinces and the communist "core" in the north. In addition to the regional differences, serious sector differences also exist. Some sectors have enjoyed full-scale development in the last two decades and are ready to compete against established competitions from overseas; while others would be under fatal attack should they be put into the same situation. For example, the Chinese consumer electronic is a relatively strong sector. A state-owned color television maker in 1996 did what any well-managed, market-orientated company would do when confronted with a tariff reduction of foreign imports. The company lowered prices of its products by to offset any price advantage the imports gained through tariff reduction and cut its costs by expanding its production to achieve better scale of economy. In the process, the 39-year-old company increased its market share from 22% to 27% and increased its after-tax profits by 46%. This example, however, is an exception other than rule. For the most state-owned enterprises, especially those heavy industries, the situations have been deteriorating even with the help from the state.

China Is Not Ready

China's economic development strategy is different from that of the former Soviet Union or the other East European countries. Instead of a rapid liberalization, China has chosen a 'gradual and partial' strategy. Giving its robust economic growth and growing participation in the world economy, China's gradual reforms and partial open-door-policy appear to have been very successful. But this characteristic, coupled with the more fundamental nature of the Chinese economy, a semi-market one with the consistent strategy of the Chinese government to maintain it, makes it different from even those non-market economies.

In some sense, Ross correctly points out that since 1949, China's economic strategy has actually been more consistent over the years than it appears. Beneath all those fluctuations, the driving force behind all of China's foreign economic relations - to make China stronger with trade and later FDI, to serve China's quest for modernization, to provide the means to acquire needed goods and to build a broad base of national industries--- is unchanged. Rather than liberalism and Marxism, China's economic behavior maybe better described as nationalism.

It has two important corollaries. First, to ensure that the state needs and priorities are met, foreign economic relations have been closely managed by the central government. Despite growing liberalization, state's interests in foreign economic relations increased rather than decreased. China's imports, for instance, are still largely governed by protectionist regulations that give preference to machinery and other producer goods, keep out most consumer goods, and ensure that China does not import items that compete with key domestic productions. On a macro-economic scale, China attempted to maintain a rough balance between its level of imports with various industrialized countries to ensure the availability of goods from diverse sources and to prevent any one country from becoming a dominant supplier. This is one of the reasons that US companies has always found it difficult to penetrate Chinese market, and that China became so upset when Japan became the dominant supplier for Chinese imports in early and mid 1980's, and that airbus and Boeing keep similar market shares in China.

While efforts to decentralize import decisions were hailed in the 1980s, the right to import directly without going through state-controlled foreign trade corporations actually devolved to the end-user only in very limited instances. Today there are more than one thousand trading companies that has trading relations with foreign companies independently, but at most they are 'limited independence' which means within certain policy restraints, they can trade freely.

China has become one of the top two foreign capital destinations (the other is US) in the world, which is also served as an indicator of China's openness, but the openness has its limits. China's policy toward investment is the same as its import policies. The principles behind encouraging foreign investments are: be large in scale and very systemic; be concentrated on high technology and new technology areas; be diverse and local-based. Same as trade, the direction and preference of foreign investment is under the control of the government.

Second, China's foreign economic relations have been consistently accompanied by a strong tendency of protectionism and mistrust of foreign influence. In the last two decades, China has tried various ways to attract foreign capital, such as the establishment of the four special economic zones (SEZs) and later the fourteen coastal cities. Today, more special economic districts are being developed where preferential taxation and other special treatments are available. On the other hand, the government intentionally always discourages investments in the areas that contains less technology or less capital intensive. Overall, China has always had great concern on the effects of foreign investment. As an example, the following policy recommendation of the Chinese scholars to the government that, "... We should make it our policy to use the market in exchange for technology and write it into the law. We should eliminate the improper market activities of foreign investors and transnational companies. Now China does not have any law to punish the unethical behavior of manipulating market," demonstrates this concern.

Therefore, the recent rapid expansion of China's share of the world trade, or even the degree of China's integration into the world economy should not be interpreted as an indication that the Chinese economy as a whole has become much more liberated. China has pursued a maquiladora-type liberalization, with export processing zones accounting for more than half of the total exports and overwhelming majority of the foreign investment going into joint ventures in these export zones. The rapid export growth in China is depended on an unprecedented degree of foreign invested firms and the export goods produced by wholly and partially foreign-funded enterprises is accounting for nearly half of the total volume. There is nothing wrong with the situation. However, when it is combined with the protection provided to the state-owned industries, it has inhibited the objective judgment of the degree of China's openness and liberalization. In another word, the hand of the government has always been the key factor in

China's 'liberalization'. Therefore, 'liberalization', which could even reach to a degree that it becomes satisfactory for China's WTO accession someday, would not fit in the WTO framework practically.

In short, China's difference lies in the fact that it has become a formidable trading power in record time outside the multilateral trading system, but all with the help of its government. Therefore, China's uniqueness lies in its combination of the characteristics of both the transitional economies and the East Asia model. This has worked both to China's advantage (attraction to others into its market) and disadvantage (its ability to cause massive or unpredicted changes in bilateral trade flows and to WTO regimes) during the negotiation.

In this sense China may not be ready for its accession to WTO. Therefore, it is a dilemma challenging China: without state control, economic reform could not start from the very beginning and cannot continue toward certain direction, or with certain speed; With state control, price is not able to take its full responsibility in market and it will create all kinds of economic behaviors inharmonious with WTO principles. To China, though painful and difficult, further liberalization is necessary.

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